

# RISK MANAGEMENT LETTER

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## PROTECTING YOURSELF AS A BANK DIRECTOR



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There is a Far Side cartoon that has two deer standing next to each other. One of them has what looks like a shooting target on his chest. The other deer says, "Dude, bummer of a birthmark." Many bank directors these days are feeling like

that deer with the target birthmark. If anything goes wrong with the bank, the persons whose stock value diminishes are going to be looking to the directors and bank management to make it right.

### WHAT IS A DIRECTOR'S RESPONSIBILITY?

Every director is required to exercise ordinary diligence in ascertaining the condition of the bank and provide "reasonable control and supervision" of the bank's business. Directors are also responsible for the supervision and direction of the bank under their charge, and they are not to indulge in self-dealings at the expense of stockholders. Directors are also required to be familiar with statutes, both state and federal, that pertain to the activities of their bank. They should be familiar with the loan limitations as to the bank's capital, federal laws concerning community reinvestment, and EPA requirements on real property collateralized loans.

Furthermore, directors cannot receive preferential treatment of any kind for loans, interest on deposits, etc. When it comes to illegal acts, i.e.,

misapplication of bank funds, bribery and graft, improper certification of checks, etc., they may be held liable and accountable for these actions perpetrated not only by them, but by other directors that they knew (or should have known) acted inappropriately. In short, if something goes wrong, directors and/or management probably will be sued. However, as my college business law professor used to say, "Any fool can sue, but it doesn't mean they'll win."

### HOW DO YOU MAKE YOURSELF A "BAD TARGET" FOR A LAWSUIT?

First and foremost, every director should look at his or her position as a sacred trust. Yes, it's an honor to be a director of a bank, but it is also a great responsibility. Here's a short list of "to dos" as a director:

- (1) Attend director's meetings and participate. Ask questions. If you don't know, ask.
- (2) Find out about the laws, statutes, and regulations that apply to your bank. You don't have to go to law school but get familiar with the important laws and statutes that affect your bank. Corporate counsel should help with this.
- (3) Pay close attention to what the courts and regulators are doing with other financial institutions. Does it apply to your bank?
- (4) Exercise reasonable diligence and common sense. Yes, don't assume the worst about

your bank's management, but do hold them accountable. If something looks wrong, or is going against what you feel is the proper direction for the bank, ask questions.

- (5) Make sure the bank has as broad an insurance program as possible. Regulators require banks to have "adequate" insurance protection. The definition of "adequate insurance" is a topic of another article altogether. However, at the very least, every bank should have a Financial Institution Fidelity Bond with a limit that meets the recommended standards set by the Surety Association of America. The regulators use this guideline as well, but be careful, your particular bank may require a higher limit than the "standard" recommended amount.
- (6) Make sure your bank has a Directors and Officers Liability policy with limits and

coverages appropriate for your bank's exposures. Again, this is a subject that demands much more time; however, this policy may be your only source of funds (besides your own assets) to provide defense of lawsuits. Your personal Homeowners and Umbrella policies will not provide protection in this area.

### **CONCLUSION**

The Bank Director has a great deal at risk and many exposures. However, with a keen sense of his/her duty and a willingness to perform it, real personal financial disaster can be minimized and/or avoided.

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