

BANK DIRECTORS AND THE PUBLIC INTEREST

William Lyon, a former New York State Superintendent of Banks, stated that bank "directors are the great reserve strength in the banking business". Bank stockholders, the general public, and the bank supervisors have all depended on bank directors to promote a sound and efficient banking system. Consequently, bank directors have been left with two responsibilities - serving the bank stockholders who elected them and serving the public which is their source of customers. In banking, this public responsibility of directors has become one of their more important duties. In fact, serving the public and maintaining public confidence in banking has typically been called the cornerstone of banking.

Bank directors, however, have not been alone in having a responsibility towards the banking public. In our banking system, they share this duty with the bank supervisory authorities. As such, bank directors and supervisors may be viewed as partners with a mutual interest in serving the public. While these two groups have had their conflicts, as with any partners, they have generally cooperated in the development of U.S. banking.

In carrying this theme forward here, I would like to trace through the historical role of the bank director and the changes that have altered this role in recent years. We can then use this perspective to gain a better understanding of today's bank director and his present responsibilities, as well as any recent legislation affecting directors. Also, I would like to discuss the director's role in terms of its coincidence with the responsibilities of the bank supervisory authorities.

THE TRADITIONAL ROLE OF THE BANK DIRECTOR

As in any business, bank directors traditionally have been responsible for directing management toward running a profitable enterprise. After the 1930's changes in the banking framework and in banker attitudes, this role of the bank director consisted largely of attracting new customers. A good bank director was often portrayed in business cartoons as a great backslapper who could take a box of cigars to the country club and come back with 15 new accounts. Furthermore, many of the directors themselves were selected on the basis of having a large account that the bank wanted to attract. And, if the bank already had the account, the same thing still needed to be done before another bank tried it.

Other duties of the bank director in the period from the depression through the early 1960's were limited by the general nature of the banking system. Part of the public confidence role in banking had been taken over by federal deposit insurance. This insurance greatly reduced the director's traditional worry of mass deposit withdrawals upon any adverse news. Also, the director's job of overseeing management was minimal compared to today's standards. Most bank assets were in the form of government securities or cash and balances with other banks. The role of providing investment funds to the economy was primarily taken on by a rising stock market. In addition, federal law and a market environment with little nonbank competition were the primary determinants of the terms to be offered on deposit accounts.

Bank directors, also were subject to a different standard of public scrutiny. Outside directors could have a full banking relationship with their bank without being subject to all of the standards that now apply.

In addition, credit relationships with a correspondent bank generally received only cursory attention from the supervisory authorities. Other items, such as overdraft policies, were never considered front page news as they now are.

THE CHANGING ROLE OF THE BANK DIRECTOR

Although I probably went too far in characterizing the past role of bank directors, I think we can all agree that a bank director's role has not become any easier in recent years. Banking has changed greatly during this period as a result of new technological developments, increased competition from other sources, and reevaluations of banking regulations and standards of conduct. Bankers can no longer take the attitude of the aging bank president who, according to an old joke, replied at his retirement party, "I've seen a lot of changes during my 50 years of banking, and I'm proud to say I was opposed to every _____ one of them". Any banker following this attitude today would soon find his customers crossing the street to his competitors.

The role of the bank director, consequently, has become more demanding in recent years. Today's director must have the knowledge, experience, and ability to actively direct the operations and management of a bank. Also, as a result of the changing nature of banking, bank directors must not only have more business knowledge, but must expend more effort to acquaint themselves with a bank's operations and its financial and regulatory environment. I am sure that all of you are familiar with these aspects of directorship.

Changing standards in banking have also resulted in increased public responsibilities for bank directors. Bank directors, in addition to their traditional role of protecting depositors, are now recognized to have an increased role in serving their communities. This community role has always existed and been a part of directorship. However, it has become even more critical in recent years with bankers placing renewed emphasis on their lending activities. Moreover, in lending to their communities, bankers and bank directors have found a strong relationship between their private and their public responsibilities - their community grows with the bank and their bank grows with the community.

In their public role, bank directors have also become subject to new standards of public scrutiny. Most of these standards were implemented in the Financial Institutions Regulatory Act of 1978 ("FIRA"). This Act prohibits director and other management interlocks between financial institutions in the same communities. It also expands and clarifies the regulatory agencies' powers to issue cease and desist orders and remove individuals from office as well as providing civil penalties for violations of laws. Finally, it places strict limits and controls on the amounts and the terms under which directors may borrow from their banks and prohibits the payment of a director's overdraft.

RELATIONSHIP BETWEEN DIRECTOR RESPONSIBILITIES AND SUPERVISORY RESPONSIBILITIES

Those of us on the other side of banking in the regulation business have similar responsibilities. The primary job for supervisors is to protect the depositor and insure the soundness of his funds. For bank

depositor protection is also an important goal, especially since directors stake their personal reputations and investment funds on meeting this objective. Hence, I think that all of us can readily agree that bank directors and supervisors have mutual interests and should therefore view each other as partners rather than adversaries in our banking systems. As bank directors, you play an important role in aiding the supervisory authorities and helping to create an effective and efficient framework of bank regulation. As bank supervisors, we look to directors for guiding bank management towards serving the public.

Bank supervisors also perform certain duties that are of benefit to directors. The most important of these is the examination function. Since this function is also performed by all of you and your holding company through audits, examinations, and monthly monitoring, the supervisory examination can best be viewed as an independent opinion. As such, all directors, and particularly the outside directors, should insist on obtaining a copy of the examination report to carefully review. This examination should not be regarded as a complete audit of a bank's condition since the examiners can only spend a limited amount of time in the bank. However, the examiners have proved to be fairly accurate in identifying such things as the sufficiency of internal bank policies and the portion of loans that will represent the major loan problems in a bank. Thus, while examiners will review a bank's general policies, bank directors are being relied upon to establish policy and to uncover any departures from this policy. When bank supervisors are unable to confirm that directors are doing this job, some supervisory action may be necessary.

Next, bank supervisors and the legislative authorities have formulated regulations and laws that affect the actions that can be taken within a bank. These regulations have been designed to counter previous problems that developed in banking. Thus, they draw on experience and attempt to codify it. While banking regulations are by no means a final answer, they can prevent previous mistakes from being repeated and can thus serve as a guide for bank directors. Examples of such regulations are loan limits to a single borrower, real estate loan restrictions, and capital standards. A number of reports and publications are also issued by the supervisory authorities that should be of some interest to bank directors. An example of this is the "Operating Ratios" publication. This can be used by directors to compare the performance of their bank to that of similar banks in the District. Lists of other reports for your review can be obtained through your primary supervisor.

RELATIONSHIP BETWEEN HOLDING COMPANY DIRECTORS AND BANK DIRECTORS

The role of bank directors has also been affected by the bank holding company movement. While little has been written or said on this topic, banking institutions have discovered a number of benefits with the holding company structure and its own board of directors. As you are aware, holding company directors in many cases have been able to design services for subsidiary banks that would not be available within a smaller organization. For example, holding company directors can arrange for lending, investment, and operational advice to be given to any or all of the subsidiary banks. In addition, the holding company directors can maintain their own audit and examination staff or hire outside auditors

for the benefit of the subsidiary banks. On the other hand, if too much power is assumed by the holding company board, then the subsidiary banks could lose local autonomy and flexibility to react to particular banking events. Also, any holdover management from pre-acquisition days may find themselves restricted in continuing policies that they consider necessary.

Since these are issues that must be resolved within each banking organization, I would like to skip to the topic of how bank supervisors will view such a director network. The Federal Reserve, as the supervisor of bank holding companies, has had a firsthand look at many of these director overlaps and relationships both during both the acquisition process and the holding company inspections program. In the application phase, a key part of the public benefits analysis focuses on the holding company directors and the services that they plan to implement for the bank being acquired and for the public. In the inspections program, we have tried to look at the internal controls and audit procedures within the holding company as well as the degree of self-direction exercised by each bank.

With our supervision of bank holding companies, we have generally chosen to assign responsibility for the condition of a holding company to its directors rather than to all the directors of subsidiary companies. If there are problems within a subsidiary bank or nonbank company, the holding company board of directors is expected to correct the situation directly or find some bank or nonbank directors that can. Moreover, if a problem arises because the holding company has failed to implement the proper policies throughout the organization, then the holding company

directors are expected to correct the situation themselves. Although this places directors of subsidiary banks in a somewhat different role than directors of independent banks, such subsidiary bank directors still must carry out the full duties of a bank director. This conduct is not only required by law and the primary supervisor of the bank, but also is necessary if the parent organization is to benefit fully from the contributions of its banking subsidiaries.

CONCLUSION

With the increased responsibilities and requirements of directorship, I think we should conclude by asking, "Why would anybody want to be a bank director?" Not only have a director's responsibilities increased, but the benefits have decreased as well. Tighter restrictions have been placed on insider loans, overdrafts, and loans from correspondent banks. The only remaining benefits from bank directorship, besides the usually minimal directors' fees, are the prestige and satisfaction of public service and the opportunity to gain insider information on other business activities in town. While you should all be commended for your public service, I think that some other benefits must be available for bank directors if we are to continue to maintain the high quality of directors.

From a supervisory standpoint, we have not fully considered the question of what is an appropriate form for director's remuneration. Some bankers have suggested that recent legislative acts like FIRA have gone too far in restricting directors' benefits. However, given the many banking problems that have resulted from insiders' self-dealings, I

believe that we must find some other answers that are acceptable to all bankers. In many other corporations, the answer has been for outside directors to be paid directly through higher fees or salaries. Although banking probably has not reached such a point yet, this method, as well as other alternatives, needs to be considered more carefully.

Lastly, I should commend you for your cooperation with the bank supervisory authorities in promoting sound banking and in serving the public. While the direct personal gains from this may be minimal, public service does carry its own reward of satisfaction.