

Director's Corner: How to Stay On Top of Your Bank's Absolute and Relative Financial Performance

By Shawn O'Brien, President, QwickRate and Greg Dingens, Executive VP, Head of Investment Banking, Monroe Financial Partners

"Good decisions begin with good information. A bank's board of directors needs concise, accurate and timely reports to help perform its fiduciary responsibilities."

—OCC, *Detecting Red Flags in Board Reports: A Guide For Directors*

Regulators have made it explicitly clear that bank directors have a responsibility to be informed of, and truly understand, the performance of the institution they oversee.

The FDIC has stated, "Directors must keep themselves informed of the activities and condition of their institution and the environment in which it operates... These reports should be carefully framed to present information in a form meaningful to the board."¹

In its director handbook, the OCC adds that directors should be asking for information frequently, and should be comparing their bank to the performance of peers. (*OCC Duties & Responsibilities of Directors (Section 501)*)

The Federal Reserve underscores the gravity of the directors' obligations by saying, "Directors should understand that if they neglect to carry out their fiduciary duties and responsibilities, they may be financially liable if the bank fails or experiences loss..."²

This is serious stuff, with serious consequences. After all, the FDIC has sued over 1,100 directors in connection with the recent bank failures tied to the credit crisis.

Finally, banks compete for capital with all other companies. Even the friendliest local investors will, over the long run, expect to make an acceptable return on their investment, or they (or their heirs) will demand their capital back in one way or another. Thus, it is incumbent on the board to ensure their bank is making acceptable returns, and the best way for them to achieve that goal is to track the absolute and relative performance of their bank, over the short term and the long term.

The data challenge for directors & bank management

The board cannot manage what it cannot measure, so the challenge is to find a way to efficiently deliver important information in a useful format. The responsibility of delivering this falls to the management team, ideally with substantial guidance from their board.

The scope of required information is large – and a challenge for bank resources already faced with growing regulatory compliance burdens. Board reporting adds the necessity to:

- Access, analyze and condense all the performance data of the bank.
- Do the same for a group of peers that can be used to place the bank's performance into context.
- Present the information in a format that can be easily digested by all board members, including those who are not inclined or formally educated toward understanding financial information.

For these reasons, many banks tell us that their Board reporting largely consists of the quarterly Uniform Bank Performance Reports (UBPR). Based on call report data, the UBPR contains historical financial performance information for the bank and peer groups. It is important to review UBPR analysis, since the regulators use this tool to evaluate the bank.

But the UBPR is an outdated, dense report that's hard to decipher. It has 40 pages of data that tends to overwhelm the important with the minutiae. It is difficult to download and even more difficult to glean any trends from this data. The UBPR peer groups also tend to be too large, and are therefore non-informative.

Essential elements for effective Board reporting

The question is, how do you overcome the UBPR

problems, without having to invest huge amounts of time, effort and expense? Before choosing an alternative, it's helpful to define what the ideal Board report should contain and look like. Here are tips to keep in mind:

Content

Consider which factors your board should be monitoring, and determine the depth of detail directors actually need for fulfilling their duties. Information overload is counter-productive, and so it's imperative to provide all the data analysis necessary, but summarize it in an overview. At a minimum, the overview should focus on the following broad categories, each one containing key analytic components:

- Balance Sheet Utilization
- Asset and Deposit Composition
- Margin Analysis: Yield and Cost
- Core Operating Earnings Analysis
- Summary of Asset Quality
- Capitalization and Growth Metrics

Performance comparisons

Performance comparisons should include both current and historical data. Directors need to see where the bank stands today, its year-over-year performance, and how things are trending over time. ROAA, ROATOE, core operating earnings and total credit cost metrics are essential.

Peer comparisons may include standard UBPR groups, but should really be composed of custom peer groups whose characteristics (size, type, operating philosophy) are very similar to your institution's. Consider developing a system for ranking and/or grading peer performances. This makes it easier to understand how the bank stacks up to other institutions and where it excels or underperforms. Provide side-by-side performance averages, rankings and grades for the bank and all peers.

Competitive analysis is another important consideration. Preparing a quarterly comparison of top peers in the bank's footprint (local, regional or other similar banks) will pinpoint where the bank is doing well currently, and where extra attention may be needed.

Format

Present the analysis in a way that will promote the most efficient comprehension by different individuals with different financial proficiencies. Keep things visual. Transform details into easy-to-grasp charts and diagrams. For example, show trends as graphs; they're much easier to interpret. Pay attention to the arrangement of data. Top and bottom performers can be spotted at a glance when they're presented in order.

Settle on a successful report format and stick with it. A consistent presentation style makes it simpler for everyone to interpret particular content in successive reports.

Available alternatives

Fortunately, we're seeing a number of automated options in the marketplace that are making Board reporting easier for community banks and relieving some of the manual burden associated with keeping directors educated and informed. We'll be showing examples that banks are currently using in our presentation at the FMS Finance and Accounting Forum.

Banks that take advantage of options like these say they're using the information for multiple purposes. Yes, it's great that they simplify Board reporting. In addition, the analytics are very helpful for managers who are working to build the bank's competitive strengths. According to some banks, these are great tools for communicating with shareholders, both at manual meetings and throughout the year. It's an effective way to share operating metrics and summarize the bank's financial health.

Directors, shareholders and managers need to be informed. The key is to be able to supply valuable information without overtaxing the bank's personnel.

¹ FDIC, *Pocket Guide for Directors*

² Federal Reserve, *Duties and Responsibilities for Directors*, Effective date April 2013

Disclaimer: The views and opinions expressed in this article are those of the author(s) and do not necessarily reflect the official policy or position of the Financial Managers Society.



Shawn O'Brien



Greg Dingens

About the Authors

Shawn O'Brien serves as the President of QwickRate. His responsibilities are to continue to enhance QwickRate's ability to deliver non-brokered funding, while also seeking to complement these deposits with additional sources of liquidity and investment options.

Greg Dingens serves as Head of Investment Banking for Monroe Financial Partners, Inc., a boutique investment banking firm serving community banks nationwide. He is also a partner in the private investment fund Siena Capital Partners.

Published by:

Financial Managers Society

312-578-1300

toml@fmsinc.org

www.fmsinc.org

www.fmsperspectives.com

Connect with us:    