Bank of Guyana

Director's Handbook

FOREWORD

The failure of financial institutions globally has drawn increasing attention to the need for sound management of financial assets and proper stewardship of the institutions. A tremendous degree of attention has been focused on the performance of decision-makers at all levels but more so at the level of the Board of Directors. The actions by the International Financial Institutions in encouraging the adoption of the Codes of Good Practices on Transparency in Monetary and Financial Policies have promoted bold initiatives by many institutions to place the conduct of directors and managers under greater scrutiny.

The noble task of serving as a director must be exercised with ethical standards that confirm with the applicable laws, regulations and guidelines. Directors must withstand scrutiny and their conduct in the affairs of the institutions must be above reproach. No director should be spared due diligence since it lends to the exercise of good corporate governance.

The *Director's Handbook* serves as a standard and quick reference for directors of the financial institutions and their management staff on the responsibilities, monitoring and evaluating tools and methodologies that are critical in performing their tasks. This useful booklet is neither exhaustive nor conclusive but implores the need for sound stewardship in the affairs of financial institutions.

I wish to take this opportunity to extend gratitude to all those who supported the research and publication of this Handbook.

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Governor

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Bank Supervision Department

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A. OVERVIEW

1. WHO IS A DIRECTOR

A director is any person occupying the position of director of a company by whatever name called. In practice, a director is a person who takes part in or is entitled to take part in the process by which an institution exercises the powers and responsibilities that it has under the law and its own articles of incorporation.

2. THE ROLE OF A DIRECTOR

The Board of Directors is responsible for the safe and sound management of the financial institution that entrusted it with that stewardship through the shareholders.

Implicitly, directors are accountable to the institution's shareholders, its depositors/creditors as well as to potential investors, employees, and the public at large.

As a director you have many specific areas of responsibilities, principal among them is good corporate governance that includes: the establishment of policies and the monitoring of operations to ensure the institution's compliance with all pertinent laws and prudential requirements. In addition, under your stewardship, the institution should be able to achieve its objectives and meet acceptable standards of accountability, probity, and transparency.

In order to fulfill this stewardship vested in you, you should be able to follow the financial performance and growth of the institution, be attentive to the affairs of the institution, become more knowledgeable and better informed to be able to identify and correct potential problems and in addition exhibit diligence, skill, care and prudence in the execution of your duties acting independent of undue influence from internal and external sources.

Failure to perform your duties and to carry out your responsibilities as a director could expose the institution to financial loss, reputational risk, and supervisory sanctions, and you to charges and penalties.

Therefore, upon your appointment you must be fully cognizant of your duties and responsibilities as a director.

3. EXPLANATORY INFORMATION

This handbook is an endeavor to provide the basic information to which both non-executive and executive directors should pay close attention in executing their duties and responsibilities. It is not intended to be prescriptive, exhaustive, or to represent all the considerations that may be necessary, but simply the minimum information worthy of being addressed. Directors are advised to refer to other relevant literature for additional guidance.

The major points presented have been compiled from various literature on duties and responsibilities of directors, some of which can be accessed in more details by referring to the references cited in the handbook.

Your thorough reading and adherence are solicited so that together we could ensure that our financial system meets its objectives whilst exercising practices of effective accountability.

Part One of this handbook deals with personal characteristics; duties and responsibilities; disqualifications; liabilities of directors; compliance with laws and regulations; corporate governance; board composition; committees; and relationships with stakeholders, including the Bank of Guyana (hereinafter referred to as the Supervisory Authority), other regulators and the external auditors.

Part Two addresses matters pertaining to financial soundness. It highlights components of the CAMEL and presents some ratios that you would find useful in understanding and analyzing those components.

The third part touches on risk management and internal controls. It is anticipated that eventually this handbook would be updated to inform directors on the criteria used by the Supervisory Authority to rate the institution.

The final part suggests additional reading sources you may find useful in building your knowledge of banking and financial matters.

B. PART ONE

I FIDUCIARY

1. PERSONAL CHARACTERISTICS

Membership on the board of directors of a licensed financial institution is a prestigious and honorable position since you have been entrusted with the safety of depositors' funds. It is also an indication of the shareholders' belief in the valuable contribution you can provide to its management to ensure on-going viability and sustainability.

Directors should therefore:

- Be willing to put the interests of the institution above personal interests.
- Be willing to commit the time necessary to prepare for and regularly attend board and committee meetings.
- Actively participate in decision-making.
- Have an enquiring, open, and independent mind.
- Exercise sound and objective judgment independent of undue influence from external and internal sources.
- Be exemplary citizens.
- Avoid conflicts of interests and self-serving practices.
- Have a basic knowledge of banking/financial business and the regulatory system.

- Exercise leadership and integrity.
- Act honestly and in good faith in the interest of the institution.

2. DUTIES AND RESPONSIBILITIES

Although the board of directors may delegate authority to management, the directors retain specific duties and responsibilities which may not be delegated to management of the institution. The primary responsibilities of the Board are as follows:

- To adopt and follow sound, written, and clearly defined strategic objectives.
- To ensure that the institution has the personnel as well as the financial, technological, and organizational capabilities to achieve those objectives.
- To comply with pertinent laws, regulations, and codes of best practices.
- To regularly attend and actively and meaningfully participate in board meetings.
- To establish and monitor good corporate governance practices.
- To establish a system to identify, measure and effectively control risks to which the institution is exposed.
- To establish internal committees that will enable the board of directors to effectively perform its duties.
- To ensure that the organization's internal controls are adequate for the nature and scope of the business.
- To ensure that these controls are reviewed and periodically tested.
- To ensure that there is an effective internal audit structure with direct reporting to the board of directors or to the audit committee.
- To ensure that members' own personal/business relationships with the institution are always at arms length.
- To ensure that members review the reports of various committees established to monitor and regulate the internal control environment of the institution.
- To ensure that technology and systems used in the institution are adequate to effectively manage the business and maintain its competitiveness.

- To ensure that an effective contingency plan is in place in the event of an adverse situation.
- To be informed of the institution's condition and performance and to monitor performance against business objectives, targets, plans etc..
- To ensure that adequate information and reports are received on a timely basis in order to be informed about the institution's condition and performance.
- To ensure sufficient/adequate capitalization of the institution.
- To serve the country's credit needs.
- To ensure that timely, accurate, and understandable information is disclosed to the public.
- To ensure that there is adequate training for management and employees.
- To select qualified and competent executive officers including the Chief Executive Officer.
- To ensure that there is a succession plan for the Chief Executive Officer and other critical management positions.
- To regularly assess your own performance and effectiveness as a whole and should also, at least, annually, appraise the performance of the Chief Executive Officer and the management team.

Effective board performance would entail each director actively embracing his/her duties and responsibilities and using the collective skills and experiences in providing independent, objective and thoughtful oversight and guidance to the institution.

3. DISQUALIFICATIONS

Sections 64 and 65 of the Companies Act 1991 (Act No. 29 of 1991) provide a list of disqualification criteria for directors. Some of the criteria are: the commission of an offence involving fraud or dishonesty; being unfit to be concerned in the management of a public company; is less than eighteen years of age; is of unsound mind and is an undischarged bankrupt.

In addition to the above, Section 26 of the Financial Institutions Act 1995 (No. 1 of 1995) (FIA) sets out some of the factors which would disqualify a person from being appointed or continuing as a director. By way of example, any one of the following circumstances would be a cause for disqualification:

- The individual has defaulted on his financial obligations to any licensed financial institution in excess of two months.
- The business practice of the individual appears to the Supervisory Authority to be deceitful, oppressive or otherwise improper (whether lawful or not).
- The individual was convicted of a felony or any offence involving fraud, dishonesty or breach of trust.

Every director is required to complete a Personal Declaration Sheet to aid the Supervisory Authority in the determination of the "fit and proper" criterion.

Sections 9(3) and 27(2) of the FIA provide the parameters for this determination but do not prevent more extensive investigations.

In addition, under section 17(2)(e) of the FIA the Supervisory Authority can prohibit or restrict a licensed financial institution and such subsidiary or affiliates from having directors in common.

4. LIABILITIES OF DIRECTORS

Under the Financial Institutions (Amendment) Act 2004, Section 30(A), directors may be held both jointly and severally liable for losses suffered by the institution and may be required to make restitution to the financial institution in the amount of the financial loss.

Directors should have a reasonably accurate understanding of the institution's financial condition and performance. If particular matters are unclear, directors should ask management to provide more information or to seek at the institution's

expense, independent professional advice on specific issues. They should only act on a fully -informed basis.

Under the FIA, a director is required to:

- Disclose a material conflict of interest.
- Not produce false and/or misleading statements or obstruct or endeavor to obstruct the functions of an auditor or the Supervisory Authority.
- Not to disclose any information received concerning the affairs of the institution except under the circumstances so permitted under the FIA.
- Provide the Supervisory Authority with all requisite documentation/ information in the performance of the duties of the Supervisory Authority and not to impede the performance of the duties of the Supervisory Authority.

Directors also have to adhere to common law duty:

- To exercise duty of care
- To exercise duty of loyalty
- To exercise duty of obedience

Duty of care means that as a director, you will devote time, exercise ordinary diligence, and use reasonable judgment to ensure that the institution is run prudently and with due regard for the institution's stakeholders.

Duty of loyalty means that you will not engage in activities or make use of information obtained as a director that benefit you at the expense of the institution neither will you abuse your position as a director.

Duty of obedience means that you will obey applicable laws in your personal dealings with the institution and ensure that the institution complies with those applicable laws, regulations, notices, guidelines etc..

5. COMPLIANCE WITH LAWS AND REGULATIONS

Directors are responsible for establishing written policies to ensure that the institution complies with all the pertinent legal and prudential requirements and to monitor the institution to make sure that the written policies are being adhered to.

Laws, regulations, guidelines, and circulars (inter alia) are designed to contribute to the promotion of a safe and sound financial sector wherein depositors can have a secure place to put their funds; businesses and individuals could have a dependable framework for conducting monetary transactions; and the monetary authority could have a reliable channel through which to conduct monetary policy.

Laws, regulations, guidelines, and circulars (inter alia) not only place limits on or prohibit policies and practices that, based on precedents, may cause banking/ financial problems, but they establish rules that would create a level playing field for all participants while at the same time provide the scope for supervisory activities.

The Supervisory Authority uses on-site examinations and off-site surveillance to determine the extent of an institution's compliance with laws, regulations, guidelines etc. and also as an indicator/early warning system of potential problems for the institution.

6. CORPORATE GOVERNANCE

Corporate governance relates to the manner in which the business and the affairs of the individual financial institutions are being managed by their board of directors and senior management. It encompasses the means by which board members and senior management are held accountable for their actions and for the implementation of oversight functions and processes.

The 1992 Cadbury Report refers to Corporate Governance as "the system by which a company is directed and controlled principally by its board of directors." Not all institutional failures are due to economic and financial crises. Failures can be caused by a lack of good corporate governance. Lack of transparency, lack of oversight, weak internal controls, incompetent directors and abuse of power are also among the elements of poor corporate governance.

The directors' responsibility is to ensure that good corporate governance pervades the institution since good corporate governance promotes general stability and successful functioning of the overall financial system.

In the pursuit of good corporate governance, directors should be aware of the provisions of the Companies Act 1991 and the Guyana Security Council's document on Code of Corporate Governance in Securities Markets which touches on various issues including the mission of the board of directors; responsibilities; orientation; training; chairman and chief executive officer; committees; remuneration; role of shareholders; financial reporting, transparency and audit; and ethics among other issues.

Directors are also directed to the standard on corporate governance as set out by the Institute of Internal Auditors and are encouraged to keep abreast of developments in the area of corporate governance.

7. BOARD COMPOSITION

Although the Supervisory Authority has not statutorily pronounced on the numerical composition of the board of directors, this handbook supports the current thinking of international supervisory authorities as well as the Guyana Securities Council's Recommendations for a Code of Corporate Governance in Securities Markets that the board of directors should comprise both executive and non-executive members who are capable of carrying out their duties in a knowledgeable, profes-

sional, and objective manner and who are capable of acting independently of undue influence from internal and external sources.

The Guyana Securities Council's Recommendation for a Code of Corporate Governance in Securities Markets states that non-executive directors should comprise not less than one third of the Board of directors.

The Companies Act 1991 advocates that a public company should have at least two members on its board. In keeping with best practices, the roles of the Chairman and the Chief Executive Officer should be separate and distinct and held by two different individuals.

Until such time as the Supervisory Authority declares otherwise on the composition of the board of directors, it would be prudent for the board to include members of various ages with diverse backgrounds and experiences who are prepared to perform their duties and obligations to the best of their ability. Although under the FIA there is no minimum number set for board members, there should be sufficient number to allow formation and functioning of committees.

8. COMMITTEES

The board can delegate authority but not its responsibilities. Consequently, the board of directors could and should establish committees comprising directors and appropriate senior management while still ensuring that the full board remains knowledgeable of the affairs of the institution. Ultimately, the board is accountable for the decisions of each committee.

The number and types of committees would depend on the size and activities of the institution and may include inter alia committees such as audit, remuneration/compensation, risk management, credit, and asset/liability management.

Committees should be provided with the terms of reference explicitly outlining their objectives, functions and reporting requirements.

Committees should comprise at least two non-executive board members. The audit committee in particular, should have at least one member who is experienced in or have adequate knowledge of accounting and/or finance.

II RELATIONSHIPS

1. RELATIONSHIP WITH THE SUPERVISORY AUTHORITY

One of the principal functions of the Supervisory Authority is to ensure that the financial sector remains safe and sound and that depositors' funds are protected.

Section 31 of the FIA provides for the supervision of licensed financial institutions. Subsection 2 gives the Supervisory Authority access to all pertinent records that relate to the operations of the institution in order to effectively determine its condition and performance.

Various tools are used to execute this supervisory/regulatory function and among them are the issuance of regulations, guidelines, notices, circulars etc.; the use of on-site inspections and off-site surveillance.

On-site inspections are conducted with various goals in mind, for example, to evaluate the overall condition and performance of the institution; to evaluate the level of compliance with laws and regulations; to assess the adequacy of the institution's internal control; to evaluate the accuracy of reports submitted to the Supervisory Authority and to review the institution's risk management system.

Under normal circumstances a licensed financial institution should be examined every eighteen (18) months unless the Supervisory Authority's early warning indicator indicates otherwise.

In carrying out off-site surveillance, trends in the financial performance and condition of the institutions are evaluated and the results provide an early warning signal of any potential problems in an institution and may trigger an on-site inspection.

The Supervisory Authority is always willing to meet, and will continue to meet, with directors (with or without the presence of the institution's senior management) to discuss any issue relating to the operations of the institution including issues relating to the List of Findings or to the Report of Inspection resulting from an on-site inspection.

The Report of Inspection should be fully reviewed by directors as the report can provide useful input to the board's own oversight of the institution. Questions and issues raised should be forwarded to the Supervisory Authority. Directors should also ensure that the institution completes any specific follow-up or corrective actions or address any recommendation in a timely manner or as specified in the Report of Inspection, or as contained in any other directive issued by the Supervisory Authority.

Directors are individually responsible for knowing the condition of the institution and should not rely on the Supervisory Authority as a major source of information to identify or correct problems. In this regard, it may be necessary for the institution to put in place appropriate/adequate measures (example: establish a Committee or have a Compliance Officer) to ensure compliance with the necessary legal and prudential requirements as well as its own internal controls.

The responsibilities of the directors and management are in no way diminished by the existence of a system for the supervision of licensed financial institutions by the Supervisory Authority.

Directors should be open to sharing with the Supervisory Authority information pertaining to its oversight of the institution. Open communication between the

board and the Supervisory Authority helps to promote trust and confidence and would certainly contribute to the mutual goal of ensuring safety and soundness in the financial system.

2. RELATIONSHIP WITH EXTERNAL AUDITORS

Directors should be cognizant of Part V of the FIA and sections 170 to 186 of the Companies Act 1991 dealing with auditing and reporting and examination by the external auditors, and with the appointment of auditors, duties of the auditors, publication of accounts, and reporting to the Supervisory Authority.

Directors should be aware that the external auditors are statutorily required, during the audit, to report as soon as possible to the directors, any fact or transaction; action or course of conduct which is a violation of any law or direction of the Supervisory Authority.

3. RELATIONSHIP WITH SENIOR MANAGEMENT

One of the board's fundamental responsibilities is to select and retain a competent management team that shares the board's vision and operating philosophy for the institution.

The Chief Executive Officer and senior management are responsible for managing the institution on a day-to-day basis within the authority delegated to them by the board and in compliance with applicable laws and regulations.

It must be understood that management works for the board and not the board for management.

The Board of Directors must ensure that:

- Management responds to board's directives including compliance with board-approved policies.

- Lines of authority and responsibilities are clearly defined.
- Management ensures that the board's strategic directions and risk tolerances are communicated and adhered to throughout the organization.
- Management keeps the directors well-informed about the institution's operations with the submission of timely, accurate and reliable periodic management reports. Key reports should at least include classified asset trends, significant loans, past due and non-performing loans, renewals, liquidity trends, off-balance sheet items, asset/liability management, expected capital needs and large depositors.
- The members of the board identify the reports to be supplied to them and the contents and frequency thereof.
- Key reports are submitted early to allow adequate time for them to be carefully analyzed in order to make informed decisions.

C. PART TWO

I FINANCIAL

1. OVERVIEW

This section is intended to provide guidance to assist directors in assessing the institution's condition and performance including identification of any adverse trends.

A director is not expected to be an expert in all aspects of banking and or financial business but his duties and responsibilities require, at a minimum, diligence and informed judgment.

In assessing an institution's condition and financial performance, a director must evaluate the following:

- Capital adequacy
- Asset quality

- Management
- Earnings
- Liquidity
- Sensitivity to Risk

The five components are referred to as the CAMELS.

Each component should be assessed both separately and together to provide an overall assessment of the financial condition and performance.

Reading an institution's financial statements can give some understanding of what an institution does and what the numbers in the financial statements indicate. However, absolute numbers are not as indicative of a situation as ratios could be. When absolute numbers are reduced to ratios, it allows for a more in-depth analysis of trends within an institution as well as allow for direct comparisons between any two or more institutions.

In evaluating any ratio, focus should be placed on the levels and trends and the reasons underlying those trends as well as the components of each ratio. Also some ratios must be examined in conjunction with others to get a holistic appreciation of the performance of the institution.

Remember that performance ratios can be affected by internal factors as well as market conditions.

2. CAPITAL

Directors must ensure that the institution's capital is adequate at all times for its level of risk exposure as well as for being in compliance with legal and prudential requirements.

Capital is essential for growth and expansion and directors need to be aware of the institution's plans and strategies for the future and how these may affect capital.

Capital is necessary as a buffer for likely/unanticipated losses, and is also necessary to maintain public confidence and also to increase shareholders' net worth.

In computing the adequacy of regulatory capital, reference is usually made to core capital (tier I capital); supplemental capital (tier II capital) and tier III capital. Together these tiers less certain deductions are called total qualifying capital.

The components of tier I and tier II capital are enumerated in Supervision Guideline No. 4. Tier III is yet to be addressed by the Supervisory Authority.

Regulatory capital is used as the basis to compute the quantum of credit exposure/ facilities that may be extended to an individual borrower or to a group of related borrowers. It is also used to calculate the international minimum capital adequacy ratios by using tier I and total qualifying capital as the numerators and risk-weighted assets as the denominator.

Currently licensed depository financial institutions are only required to maintain regulatory capital in relation to the credit risks exposures but would soon be required to hold capital against other risks including market and operational (Tier III).

A licensed financial institution faces more than credit risk and those other risks would require a certain level of capital to be maintained. Therefore the institution should maintain its capital above the regulatory minimum.

Where the institution accepts deposits, it is required to maintain at all times, while its license is in force, a minimum unimpaired paid-up capital of G$250 million; if not a deposit-taking institution then there are other specific determinants for the level of capital to be maintained.

A financial institution cannot declare, credit or pay any dividend, if such payment would result in the impairment of the paid-up or assigned capital.

To be able to disburse large credit exposures, a capital base that would allow for such disbursement without breaching the statutory lending limits must be maintained by the institution.

Reduction of the institution's capital would result in the Supervisory Authority requiring the institution to, among other things, increase the capital, suspend the payment of dividends, restrict asset growth, and restrict certain activities.

Financial ratios can be used to evaluate the institution's capital position and to provide more useful information than dollar values.

For example, result from the ratio capital/assets can trigger questions like – is asset growth impairing the institution's ability to maintain adequate capital? What plans are there to augment capital?
Cash dividends/net income – does dividend payout take into account the institution's capital needs?

Some **Ratios** to be considered in evaluating the institution's capital.

- Budgeted capital / Actual capital
- Capital / Total assets
- Tier I capital / Total risk-weighted assets
- Total qualifying capital / Total risk-weighted assets
- Debt / Equity
- Cash dividends / Net income

Remember that evaluating and planning for the institution's capital need is a major responsibility for directors. Therefore, directors must monitor the capital position on an ongoing basis and identify factors that may influence the adequacy of this position over time.

3. ASSETS

In assessing the quality of the bank's assets, a director should focus on those assets that are core and that sustain the institution.

These would include principally at this time, the loans and investments. However, a director should be aware that a bank could suffer other asset losses. For example, the bank may suffer depreciation in its securities holdings because of market interest rate changes or issuer default or the bank may see a decline in the value of its real estate holdings because of poor market conditions.

Since adverse development in a bank's loan portfolio could quickly reduce earnings, deplete capital, and possibly result in insolvency, it is imperative that the institution establishes policies to guide its lending activities and continuously monitor its compliance with those policies.

Because a bank is the primary vehicle for financial intermediation, and loans would usually constitute the major portion of the bank's assets, greater concern should be associated with the quality of the loan portfolio.

The board of directors should ensure that the bank has a well-documented credit policy manual that states its objective, details credit underwriting standards and administration procedures relating to:

- loan application review
- loan approval – level for lending officers
- loan disbursement
- collateral
- loan monitoring
- classification
- provisioning
- write-offs/charge offs

- restructuring
- suspension of interest
- credit concentration by individual/group/region/economic sector
- single borrowers limits
- foreign currency denominated loans
- foreclosure procedures
- repossessed assets
- aggregate loans for the bank in dollar value or proportion of total assets
- reports to board of directors
- collecting on delinquent loans
- exception to loan policy
- periodic review of portfolio

Directors should also ensure that the policy is communicated to all relevant staff, implemented and adhered to and regularly reviewed.

The risks associated with intermediation cannot be totally avoided but can surely be minimized if directors are aware of those risks and have a proper risk management procedure in the credit policy manual or in the risk management manual, for identifying, measuring, monitoring, and controlling those risks.

Principal among the risks associated with credit disbursements are credit risk, interest rate risk, and liquidity risk. Other risks may include operational, legal as well as foreign exchange.

How well the institution manages the above risks would help determine its profitability and viability.

Some **ratios** to be evaluated in monitoring the quality of the bank's credit portfolio include:

- Non-performing loans / Total loans
- Non-performing loans / Total assets

- Provision for loan loss / Non-performing loans
- Total capital / Non-performing loans
- Non-performing loans / Total capital plus reserves
- Gross loans / Total assets
- Past due loans / Total assets
- Past due loans / Total loans

Significant changes in the ratios should trigger your concern and incite your questions to management.

4. MANAGEMENT

How could a director evaluate management performance seeing that he/she is a part of the bank's management team and is ultimately accountable for its safe, sound, and efficient operation?

First directors have to ensure that the institution has a capable senior management team, headed by a competent Chief Executive Officer/General Manager to manage the daily operations, and to make sure that succession plans are in place to provide for its future management.

Directors should attend meetings of the Board of Directors and should participate in the deliberations and ask questions if they are not clear about what is being presented. A director needs to be an independent thinker and a good questioner.

Directors should request reports, including reports on large disbursements, delinquent loans, audit and compliance from management, in a format that would allow them to assess whether management is adhering to policies and procedures approved by the board.

Directors could verify information/data received through the use of internal and external audit reports and the Report of Inspection from the Supervisory Authority.

In evaluating management, directors should not only focus on financial performance but should look beyond the numbers to the organizational and operational matters that produced the operating results. Try to ascertain why the institution performed as it did and determine if that performance is sustainable or can be improved.

In reviewing all of those reports directors should be able to formulate a more or less accurate qualitative picture of the management team.

There are some other questions directors could ask and seek answers to in evaluating management. Among them are the following:

- Is the institution complying with all pertinent laws, regulations etc?
- Is the institution in full compliance with all accounting standards?
- Is management prompt in addressing the recommendations given in the Report of Inspection from the Supervisory Authority, or any other specific directive from the Supervisory Authority?
- How does the institution compare with other similar institutions with respect to asset quality, earnings, income etc?
- Are the decisions of management consistent with the goals, plans and policies set out for the institution?
- Has management implemented a corporate structure that establishes lines of authority and accountability?
- Has management established information system to provide timely information on the performance and condition of the institution and to quickly identify potential problems?
- Has management instituted a system to identify, measure, monitor and control the institution's risk exposure in all areas of operations?
- Is management adhering to internal policies and procedures?
- Is staff morale high or low?
- What is the rate of staff turnover and the cause(s) for such turnover?
- Is staff remuneration competitive?
- Is there a structured and effective training program?

5. EARNINGS

Earnings give an indication of how well the institution is performing financially. Earnings allow for asset growth, internal capital formation, payment of dividends, and could even compensate depositors in terms of better return on deposits.

Interest income from loans and investments usually comprises the larger portion of some the institutions' income. However, directors must also be cognizant that non-interest income from fees, service charges and commission is fast becoming a burgeoning source of income.

Directors must be aware of the sustainability of the earning sources as this is vital to the continued viability and profitability of the institution.

If an institution is capable of generating substantial earnings but its expenses are very high then the institution and the various stakeholders would not benefit optimally.

Therefore the sources, level, and quality of the institution's earnings and the level of expenses as well as the external and internal factors that could impact both should be evaluated carefully by the directors.

Although directors may not be able to control the external/exogenous factors, they should endeavor to reduce the internal ones through the application of appropriate policies, including the institution's business strategy, and procedures and risk management system.

For example, one aspect of the business strategy could be on the proportion of earning assets to total assets i.e. the asset mix. A director should be aware that only earning assets could generate income. This is not to advocate that the institution should be exposed to unnecessary risks in the quest to have substantial return on earning assets.

Some key earning ratios are as follows:

- Return on assets (ROA) - net income/average assets – this is one of the most frequently used measures to evaluate performance.
- Return on Equity (ROE) also often used as a measurement to evaluate performance.
- Interest expense / Average assets
- Net interest income / Average assets
- Net interest income / Gross income
- Non-interest income / Average assets
- Provision for loan losses / Average assets
- Net income before gains, losses and taxes / Average assets
- Non-interest expenses / Gross income

In reviewing the institution's earnings, directors should enquire whether any act is being done simply to "window dress" earnings for the current period as this approach may not be sustainable in succeeding periods and may even compromise earnings.

6. LIQUIDITY

Liquidity refers to the ability to readily meet liabilities as they fall due (to quickly raise cash to serve the customers and operate efficiently) without making costly balance sheet adjustments.

Directors should be aware that rumors about an institution's ability to meet its liabilities particularly deposit liabilities could adversely affect the institution and possibly lead to a run on the institution that could cause it to fail.

Therefore it is essential that directors implement policies and procedures to ensure that the institution's liquidity position is carefully assessed daily through asset/liability management. This assessment should consider inter alia, the readily

available funding options/sources, costs, statutory requirements - with respect to the level of liquid assets that a deposit-taking institution is required to hold, and future liquidity needs.

Two useful tools for assessing the bank's liquidity positions are the liquidity gap and the liquidity forecasts.

Liquidity gap analysis provides a picture of the institution's future funding needs by comparing the amount of assets and liabilities maturing over a period of time. This comparison allows for the identification of any large maturity mismatches that may place liquidity strains on the institution.

Large maturity mismatches between assets and liabilities should be avoided. Large negative mismatches may mean that the institution is poorly positioned to meet unexpected funding needs without incurring significant cost.

Liquidity forecasts identify possible future events, project how they might affect a bank's funding needs and indicate how these needs may be met. The frequency of preparation of these forecasts would depend on the institution's financial condition.

Besides the liquidity gap analysis and the liquidity forecasts, a director may need to look at the liquidity ratios below.

- Liquid assets / Total assets
- Liquid assets / Short-term liabilities
- Liquid assets / Total demand & time liabilities
- Liquid assets / Average total demand & time liabilities
- Liquid assets / Savings & time deposits
- Deposits / Total loans & investments

D. PART THREE

RISK MANAGEMENT
(Sensitivity to Risk)

Risk is the potential that events, unexpected or unanticipated, may have an adverse impact on an institution's capital and earnings.

Risk-taking is a necessary part of any business and licensed financial institutions are no exceptions.

To manage risk effectively, an institution must first be able to identify all the significant risks it faces, have an understanding of those risks; assess their potential impact and/or associated liabilities, and have policies in place to manage, monitor and control them effectively.

The board should establish the institution's risk tolerance for each type of identified risk and approve policies that set limits for the nature and level of risk the institution is willing to assume and to weigh those risks against the institution's capital.

Directors must ensure that the approved written policies are being adhered to throughout the institution. They must ensure that those policies are reviewed regularly and that they remain appropriate in light of changing circumstances, taking account of how effective they have been under past circumstances.

Depending on the specific types of businesses conducted by an institution some likely risks would include: credit, compliance, fiduciary, liquidity, legal, market, operational, settlement, technology, country, transfer, reputation and conglomerate.

INTERNAL CONTROLS

Directors are ultimately responsible for ensuring that a system of internal control is established and maintained. They should ensure that regular reviews are done to

determine that the internal control mechanism works as expected and that it remains appropriate.

Directors must be aware that internal controls facilitate the efficiency of operations, contribute to effective risk management, assist in compliance with applicable laws and regulations, help to identify potential opportunities for the commission of frauds, and strengthen capacity to respond appropriately to business opportunities.

Reports from the internal and external auditors should give directors some insight on the effectiveness, efficiency, and adequacy of the internal control system.

E. PART FOUR

RELATED REFERENCES AND WEBSITES

1. Role of a National Bank Director, The Director's Book (Washington D.C. Office of the Comptroller of the Currency, March 1997)

2. Forest E. Myers, Basics for Bank Directors, Third Edition (Division of Supervision and Risk Management, Federal Reserve Bank of Kansas City, December 2001)

3. A Director's Guide to Board Report, Red Flags and Other Points of Interest (Washington D.C. Office of the Comptroller of the Currency, July 1989)

4. Companies Act 1991 (No. 29 of 1991)

5. Financial Institutions Act 1995 (No. 1 of 1995) Enacted in Guyana, May 25, 1995

6. Supervision Guidelines Nos. 1 - 7

7. Websites:

    - www.bankofguyana.org.gy
    - www.theiia.org
    - www.sarbanes-oxley.com
    - www.nacdoline.org
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    - www.bis.org

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