

NEW YORK COMMUNITY BANKS

OPERATIONAL ISSUES & BEST PRACTICES

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NEW YORK STATE SUPERVISION OF COMMUNITY BANKS

- New York charters and supervises 80 community banks:
 - 51 commercial banks,
 - 19 savings banks, and
 - 10 limited-purpose municipal commercial banks.
- We are using a sample group comprised of 10 of the commercial and savings banks:
 - located in lower New York encompassing the Mid-Hudson, New York City and Long Island regions of the state, and
 - have respective year-end 2010 total assets ranging from about \$60 million to nearly \$12 billion.
- We have taken from their most recent examinations the significant operational issues that have been reported along with the related suggested best practices.



OPERATIONAL ISSUES & BEST PRACTICES FOR COMMUNITY BANKS

- Audit Committee Independence, Oversight and Competency:
 - Audit committee meetings' minutes are brief and lacking in essential details.
 - Minutes should reflect that the members are actively engaged in oversight of both internal and external audit; all motions should be documented; and the committee should approve the annual audit plan and subsequent changes to it; etc.
 - Quarterly audit committee packages for internal audit activities are inadequate for committee's oversight.
 - Best Practice: Internal Auditor should present sufficient information to the committee so they can exercise proper oversight, including presentation of the annual audit plan and quarterly status report, new audit report issues (at a minimum high and medium risks), open issues and past due issues.



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- Audit Committee Independence, Oversight and Competency (cont.):
 - Internal Auditor was not given the opportunity to meet with the audit committee privately without the presence of senior management.
 - The Internal Auditor should have the opportunity to meet with the audit committee in executive session without any member of management present.
 - Internal Audit engages in operational functions.
 - To retain an objective opinion Internal Audit must not be involved in performing functions they are responsible to audit.
 - There is no audit committee charter.
 - The charter should include the structure of the committee, their independence, financial literacy, frequency of meetings (at least quarterly), and state their rights to have access to all of the books and records of the bank.



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- Audit Universe, Risk Assessment and Annual Audit:
 - The Risk Assessment methodology was not comprehensive enough to include all applicable inherent risks.
 - The model should employ a number of inherent risks relative to the business environment. Some suggested risks include credit, market, operational, legal/compliance, regulatory, reputational, liquidity and other related risks.
 - A separate risk assessment model does not exist for IT related units.
 - The risks associated with the IT environment are substantially different from the business lines and a separate set of risk factors should be established.
 - Audit frequency was inadequate or unacceptable for certain areas.
 - Most community banks have an audit cycle of three years. High Risk entities are normally covered every 12 months, medium every 24, and low risk every 36 months.



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- Information Technology:
 - The information security officer (ISO) responsible for customer information security reports to someone in the IT department.
 - The ISO should have an independent reporting line to either the board or senior management (required by the Gramm-Leach-Bliley Act).
 - There is a lack of Business Continuity Plan (BCP) and substantially incomplete Disaster Recovery Plan (DRP) with unrealistic target dates.
 - A BCP/DRP should include strategies and procedures to maintain, resume, and recover critical business functions and processes, as well as procedures to execute the plan's priorities for critical vs. non-critical functions, services and processes.



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- Information Technology (cont.):
 - The Bank outsourced its entire core processing and the outsourcing company performs their BCP and DRP testing frequently; however, the bank does not participate in these tests.
 - Management should participate in the BCP/DRP testing conducted by their service provider, particularly those that provide critical and high risk services.
 - The IT policy lacks user access rights administration.
 - The policy should be enhanced to include the approval, implementation and monitoring processes.



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- Accounting:
 - Accounting policies and procedures were not reviewed and updated at least annually.
 - Accounting policies and procedures should be updated at least annually and reviewed by the CFO, with policy presented to the bank's board of directors.
 - The CFO had access to enter general ledger entries.
 - CFO access should be restricted so that he may only review data and not have the ability to alter data.
 - Accounting is not performing an analysis of changes in balance sheet and income statement balances.
 - A formal process should be in place whereby variances in account balances over a certain percentage over a predefined period would trigger further review.



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- Accounting (cont.):
 - Open un-reconciled items were noted in the accounts receivable account.
 - All accounts should be reconciled on at least a monthly basis, with items aged and placed in buckets according to the time period that they remain un-reconciled, and this report sent to management.
 - The institution does not have a write-off policy.
 - The institution should have a write-off policy whereby items are written off after a determined period (e.g., 90 days) unless resolution is imminent and appropriate approval obtained.



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- Funds Transfer:
 - There is improper access or controls to the funds transfer system.
 - Proper physical and logical access controls should be in place, including:
 - separate and secure area;
 - user access established only upon proper request by management;
 - security officer is not involved in the processing of funds transfer activity;
 - separate user ID and password;
 - proper safekeeping of token keys for Fedline Advantage.



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- Funds Transfer (cont.):
 - Lack of reconciliation of daily activity.
 - There should be daily reconciliation of daily activity and corresponding bank accounts.
 - User access for terminated employees were not removed.
 - Periodic review of access rights to assure the appropriate need of all individuals with access.



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- Vacation Policy:
 - Sensitive employees were not properly identified.
 - Sensitive employees should include all employees that have the ability to engage in transactional business or have the ability to change the books and records of the bank.
 - Exceptions for the same individuals in successive years were not prohibited.
 - The Bank should monitor for repeat exceptions and not allow employees to request successive exceptions.
 - No reasons were given for waivers or no provision for exemption was established.
 - Request for waivers should include the reason for the requested waiver and approval should be required for all waivers.



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- Other Operational Issues:
 - An introduction of new product/service was not discussed or approved by the board.
 - All necessary analyses associated with new product/service should be reviewed and approved by the board. The analysis should ensure compatibility with the bank's business strategies.
 - The CFO is the sole individual selling/purchasing securities, receiving confirmations, and performing reconciliations.
 - The bank should have adequate polices to enforce and improve the segregation of duties.
 - Slotting errors were made on the Call Report due to system constraints and inputting errors.
 - A periodic review by an individual independent of the report preparation area is recommended.



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Thank you.

