State of New Jersey

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BULLETIN NO.: 02-23

TO: ALL STATE-CHARTERED SAVINGS AND LOAN ASSOCIATIONS AND CREDIT UNIONS

FROM: HOLLY C. BAKKE, COMMISSIONER

RE: CORPORATE GOVERNANCE AND BOARD EXAMINATIONS OF SAVINGS AND LOAN ASSOCIATIONS AND CREDIT UNIONS

Recent bankruptcies of several large corporations re-emphasize the importance of corporate governance to the proper management of savings and loan associations and credit unions. Proper governance includes the Board of Directors' (or Board of Managers') annual audits of the condition of their institutions. The purpose of this Bulletin is to remind state-chartered depository institutions of their general responsibilities regarding corporate governance and the internal audit.

CORPORATE GOVERNANCE

Approximately every two years, the Department's Office of Depositories reviews the corporate governance of state-chartered depository institutions during the safety and soundness examinations it conducts pursuant to N.J.S.A. 17:12B-172 (savings and loan associations), and N.J.S.A. 17:13-112 (credit unions). Evaluating the corporate governance of a depository institution is an important element of these periodic examinations and includes an evaluation of management as a part of the CAMELS analysis.

The examination evaluates the role of the Board of Directors (or Managers) and senior management focussing primarily on the following elements:

- The independence of the Board;

- The skill, experience and integrity of the Board and senior management;

- The success of the Board and senior management in establishing, maintaining and enforcing sound policies, practices and procedures for internal controls and risk management;

- The success of the Board in actively overseeing the financial affairs of the institution, including arranging for an annual audit of the institution as required by N.J.S.A. 17:12B-176 and N.J.S.A. 17:13-98, respectively.

- The success of the institution in meeting community credit needs.

- Successful compliance with statutes and regulations.

- Avoidance of conflicts of interest and preferential transactions involving insiders.

The Department periodically offers seminars for Directors of state-chartered depository institutions regarding the responsibilities of Boards. It also discusses the liability exposure of Boards under current law. For those Directors or Managers who wish guidance regarding their responsibilities, this seminar may prove helpful.

BOARD AUDITS OF SAVINGS AND LOAN ASSOCIATIONS

State law requires that each Board of Directors (or Board of Managers) cause an audit to be made of the affairs of the institution at least once in each calendar year. N.J.S.A. 17:12B-176. The examination shall be conducted by a competent accountant who is not a director, officer or employee of the association. The minimum scope for the Board audit is set forth in detail at N.J.A.C. 3:29-1.1 et seq. In addition, the audit shall comply with the audit requirements of the Office of Thrift Supervision.

Each audit shall include a verification of at least 20% of the members' accounts. A written report of the audit shall be made and submitted to the Commissioner within 90 days of the commencement of the audit. Depository institutions with a continuous audit program shall submit a copy of the audit to the Commissioner at a specific time annually to be determined by the Commissioner. N.J.S.A. 17:12B-176.

An internal audit program may be excused from the requirement to confirm with depositors and debtors the correctness of the deposits due them and debts owed the institution provided that the institution furnishes the Commissioner with sufficient proof that its internal auditors have the capacity to perform the confirmation requirements. Institutions utilizing this provision shall file a recapitulation of the results of the confirmation program with the Commissioner annually. N.J.A.C. 3:7-3.5.

<u>BOARD EXAMINATIONS OF CREDIT UNIONS</u>

Each credit union shall elect an Examining Committee which shall be composed of at least three members, none of whom shall be an officer, Director, or a member of the credit committee. At least one-third of the members of the Examining Committee shall be elected by the members at the annual meeting. N.J.S.A. 17:13-98.

The Examining Committee shall make, or cause to be made, a thorough audit or examination of the condition of the credit union as of December 31 of each year. It shall file a copy of the audit report with the Board of Directors on or before March 31 of each year. In addition, the Examining Committee shall verify members' accounts at least once every year. N.J.S.A. 17:13-98.

The Examining Committee may call a special meeting of the members to consider any violation of "The Credit Union Act of 1984", or the credit union's charter or bylaws, or to consider any practice that the Committee considers unsafe or unsound. The Examining Committee may also, by unanimous vote, suspend any officer, member of the Board of Directors, or member of the Credit Committee for good cause until the members can meet to consider the matter. The meeting of the members shall be held between 7 and 21 days following the suspension. If the matter is ratified by the members, the Examining Committee shall refer it to the Board for appropriate action. N.J.S.A. 17:13-99.

In addition to the Examining Committee, the Board may appoint an Executive Committee that may act on behalf of the Board, except that the Examining Committee may not act while the Board is convened, declare a dividend, amend bylaws, appoint an officer or director, or exercise a powers specifically exercisable by the Board. See N.J.S.A. 17:13-97.

The Board or the members may appoint a Credit Committee pursuant to the bylaws of the credit union. A majority or the Credit

Committee is required to approve or deny loan applications. If the credit union bylaws permit, the Credit Committee may appoint one or more loan officers who may approve or deny loans pursuant to the general loan policy established by the Board. Not more than one member of the Credit Committee may be appointed as a loan officer. Such appointed loan officers are required to report all applications approved or denied, and the denied loans are to be reviewed by the Credit Committee. No person may disburse funds for a loan that was approved by him or her as loan officer.

10/29/02	/s/ Holly C. Bakke
Date	Holly C. Bakke Commissioner