

The



Chairman's Forum

Opening the door to new ideas

Newsletter

Gerrish Smith Tuck, Consultants and Attorneys

August - September 2017

In this edition of *The Chairman's Forum Newsletter*, we look at a recent issue brought to our attention by a Chairman of the Board. This involves the true role of the Board's Compensation Committee and the appropriate governance procedures for it. In addition, we also look at a couple of recent client concerns relating to the true role, function and duties of Board members and Chairmen, and how to set appropriate expectations for them. Finally, we look at odd (or even) Boards of Directors. How do you move forward on strategic transactions if there is a split among your Board and should you always have an odd number of directors to prevent a stalemate?

We think you will find many of these items relevant to the day-to-day functioning of your Boards and your role as Chairman in overseeing these items. We hope this information is helpful to you. If you have questions, please let us know.

Happy Reading!

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and

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Chairman's Summary

- ◆ Comp Committee best practices.
- ◆ What is really expected of a director?
- ◆ Do you have an odd Board?

Comp Committee Best Practices

We recently received a question from a Chairman of the Board regarding some of the best practices and corporate procedures for running a Board Compensation Committee. Not surprisingly, the issue of proper Board mechanics really came to light for this organization as it began to consider the possibility of implementing a long-term incentive plan for the Board and management. We find that scenario to be pretty typical where governance issues rarely come to the forefront until mechanical processes or best practices begin to be questioned. So, in and of itself, this raises the point that the Chairman of the Board should continue to be diligent in seeking out best practices in all areas regardless of whether current issues are being faced by the organization in a particular area.

As it relates to this particular Chairman's questions about governance issues and the Compensation Committee, we are setting forth below some of the practical advice we provided and, don't worry, he paid the same amount for the advice that you are paying in reading this!

- Typically, a Compensation Committee is composed primarily of outside Board members constituting either the entire Committee or at least a majority of the Committee.
- If the Compensation Committee is not entirely composed of outside Board members, then we suggest a majority of the Committee members be non-management outside Board members provided the Board members are "strong enough" to override management's thoughts and recommendations if and when necessary. The point is to be able to demonstrate a clear separation of duties between the Board's oversight role of compensation matters and management's natural desire to want to influence compensation levels for management.
- If a Compensation Committee is comprised entirely of outside Board members, expertise in up-to-date management compensation practices may be lacking. Therefore, the Committee should feel comfortable retaining outside assistance from a firm to provide guidance and direction on standard industry practices (we know a really good one if you need a reference!).
- The use of an outside consultant might be especially helpful if the Board is trying to consider the adoption of any type of program that would benefit Board members as well. That certainly helps provide

an additional layer of governance to ensure the Board is appropriately exercising its fiduciary duties without conflicts of interest.

- If the Compensation Committee contains members of management and proposals for management compensation are being considered, the management members are welcome to be part of the consideration and deliberation, but they should recuse themselves at an appropriate time to allow the independent members of the Committee to discuss matters openly without the effected officers or directors being in the room.

While we want to separate the functions of the Board and management in establishing an incentive compensation program, we also do not want the directors blindly setting unrealistic performance goals and objectives that wind up becoming a disincentive to management. Therefore, there needs to be some collaborative effort with members of management in helping to determine appropriate performance targets or other measurable benchmarks to be achieved so that overall organizational value is enhanced. But setting the bar too high may drive a weaker performance than otherwise could be achieved. There certainly is a point of diminishing returns.

Our organizations should be proud to tout that they have a well-paid Board and management team. That is not something of which we should be ashamed. Rather, why not take the approach that our organization is the best place to work, we pay the most money to our folks, and, therefore, we expect the most out of them. As a result, everyone wants to work for our organization because it is the best, demands the most and pays the most. A

well-paid management team that knows their job and performs it well is often a Board of Director's best insurance policy against decreasing shareholder value and potential future liability for the director.

While the Board certainly has a supervisory and fiduciary role with regard to the Compensation Committee, Board members should also recognize that their job is not to set the compensation for every member of the organization. Arguably, the Compensation Committee's primary salary setting job is that of the CEO and the CEO determines everyone else's salary. If the Compensation Committee demands involvement at lower levels of the organization, that is tantamount to micromanagement.

What is Really Expected of a Director?

What do you really expect your Board members to do? What are their true job functions or job duties? Is their role merely advisory? Is their role merely ceremonial? Is the role of the Chairman really ceremonial or honorary? We believe a well-run organization has a Chairman and Board of Directors that are not merely advisory and not merely ceremonial positions, but have actual duties and obligations. But we often see that Boards struggle with figuring out those roles and duties on a day-to-day basis.

We believe the solution to that problem is to take the time to develop written job descriptions or at least a list of expectations for the positions. When you set about doing that, you may find areas you assumed there was consensus on or that are always understood, and that may not necessarily be the case. For example, is there an expectation or a requirement of the job of

a director that he or she has to attend every Board meeting in person (not by telephone conference or otherwise) or if they have more than one unexcused absence their name will not be submitted for nomination as a director the following term? Similarly, do we have a requirement in a director's job description with an expectation of a minimum number of continuing education hours each year? Just like doctors, lawyers and accountants are required to pursue continuing education each year, why shouldn't your Board members have some minimal education requirements each year? Those expectations might be met merely through on-line training, reading this or similar newsletters, attending annual state or national conventions, or similar opportunities. An engaged Board is an educated Board.

So, we recommend writing a job description and list of expectations for Board members that will either add substance to what is already being done or provide new direction and heightened expectations to enhance overall performance.

Finally, do you expect your Board members to assist in business development? While we do not want our directors running around quoting loan rates, we certainly want them using their spheres of influence to be an advocate for the bank (if not a marketer and salesperson) and to attempt to drive business toward the bank. As we sometimes jokingly tell directors, you were not selected based solely on your good looks. We want and need you to help us with new business development.

Do You Have An Odd Board?

Every so often, we get asked the question of whether a Board of Directors should always consist of an odd number of directors as opposed to an even number of directors. For example, is nine or eleven better than eight or ten? This only comes up in the context of asking what would the Board do if it ever had a split vote on something. In most community banking situations, split votes rarely occur, but just in the past couple of months we have had two circumstances with an even split in the vote of a Board on a particular strategic direction the organization wanted to take. In each of those cases, it is our belief that the issue was not so much that there was an exact split vote, but that the vote was close at all. For example, if a ten-person Board were split five to five on a vote, would that really be any different than if the vote were five in favor, four against and one abstain? Or even if the vote were six to four, would that make a difference? In most cases we see, Boards are reluctant to move forward with any type of major strategic decision if there is “only” a simple majority vote. Most organizations want a clear consensus and clear overwhelming vote in favor of a transaction before moving forward. As a result, rarely do we see the benefit of trying to ensure an odd number of directors as opposed to an even number of directors. Rather, if there is a close vote on a matter or even a split vote, that does not necessarily mean there is a stalemate, but the parties need to continue to work together to resolve the differences and come to the best strategic decision. The sign of a healthy Board may be an organization that does not always have unanimity of thought. Hopefully, we ask the men

and women to serve on our Boards because they bring different ideas, different perspectives and the combination of all their experiences and thoughts leads to the best value for our organization.

Meeting Adjourned

As we head into the Fall months and end of the year strategic planning begins wrapping up, if you have various strategic planning needs or strategic questions you would like to have answered or topics you would like to see us address perhaps through the newsletter, please do not hesitate to contact us. We look forward to visiting with you soon.

Until next time,



Philip K. Smith

and



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