The

Chairman's Forum

Opening the door to new ideas

Newsletter

Gerrish Smith Tuck, Consultants and Attorneys

November 2017

On November 6 and 7, we had a wonderful Community Bank Chairman's Forum in Hilton Head where directors from across the country met to discuss key issues impacting their role as Chairman of their organizations. The session was filled with lively discussion with topics ranging from the very basic (How long should my board meetings last?) to the detailed (How can a bank elect Subchapter S status if it has more than 100 stockholders?). Through these interactive discussions, we think a lot of new best practices were unveiled for those in attendance. As we look to schedule our Chairman's Forums in 2018, we hope that you will make it a point to attend one of these exciting events.

In this month's edition of *The Chairman's Forum Newsletter*, we expand a bit on some of the topics that were covered during the Chairman's Forum and, in particular, we look at some of the very basic issues that may often go overlooked, but where the Chairman plays a vital role. In particular, this includes looking at five key ways to improve your board meetings and looking at a provision you may have in your Articles and Bylaws that you rarely think about, but could have a major impact on your organization. That item is cumulative voting.

We hope this information is helpful to you and look forward to talking to you soon.

Happy Reading!

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Chairman's Summary

- Require your board members to be prepared before the meeting.
- Utilize a consent agenda, where possible.
- Have actual board meetings, not management meetings.
- Don't get stuck in the past. Require forward-looking discussions.
- Implement director evaluations and succession planning.
- Understand cumulative voting and how it impacts your board.

Five Ways to Improve Board Meetings

Since the beginning of the Great Recession, community bank boards of directors have experienced a different reality than they had in the past. Not only did regulatory expectations for boards skyrocket, but director liability for failure to properly oversee the institution did as well. With new regulations and new expectations, many community bank board meetings have become scattered. Although board meetings should be flexible so that all pertinent issues can be addressed, it is time for the Chairman of the Board to focus the organization on improving overall board structure and efficiency of meetings.

1. Require your board members to be prepared before the meeting.

The Chairman of the Board should require that board members are prepared before the meetings by ensuring that board packets are received well in advance of the meeting, not merely the day before. A director who receives and begins to review materials when he or she gets to the meeting will spend more time reading numbers and less time discussing strategy for the bank. Valuable meeting time is then spent either reviewing information that could have been distributed electronically a week earlier or bringing one or two directors up to speed. Either scenario promotes inefficiency and the Chairman should take responsibility for eliminating that behavior. If accumulating information and compiling physical board packets is overly burdensome, consider using technology, such as electronic board portals or secure online file sharing.

2. Utilize a consent agenda, where possible.

Far too many boards engage in time consuming discussions and decisions on routine tasks. One way to make meetings more efficient is for the Chairman to utilize a consent agenda which combines routine items that must be approved by the board, such as the prior month's board or committee meeting minutes and which is distributed to the directors for review prior to the meeting. Rather than presenting and voting upon each of those items one-by-one at the meeting, the Chairman directs that those in attendance review the materials prior to the meeting, pass the consent agenda as a whole with one motion, and spend the meeting discussing more substantive items.

3. Have actual board meetings, not management meetings.

The Chairman needs to take the leadership role to ensure a true board meeting is held, and not merely a management presentation. Directors often end up sitting quietly while management presents financial statements and otherwise dictates the topics of discussion at the meeting. While information and input from management are critical to the board remaining informed, the directors, not management, should “run the show.” The board should set its own agenda, including what information it needs from management, and discuss those issues that it identifies as substantive. The board is elected by the shareholders and charged with overseeing the bank, including overseeing management. Management is hired to run day-to-day operations. The Chairman’s role is to ensure that the duties of each are clearly delineated and that the Board exercises its fiduciary duties at the board meeting.

4. Don’t get stuck in the past. Require forward-looking discussions.

The Great Recession caused boards to continuously look in the rearview mirror. For some community banks, that means looking a few years back to avoid making the same asset quality mistakes. However, for most community banks, it simply means that the bank’s board is focused more on the previous quarter than it is on the upcoming one. With so many changes occurring in the industry, the Chairman of the Board should ensure that the group focuses more on how to enhance shareholder value in the future and stop focusing so much on past results. The board should identify where it wants to be in one year, three years, etc., what current issues will help or hinder that progress, and how the bank should address those issues. This exercise will provide a much more vibrant discussion than afforded by a review of old, static data.

5. Implement director evaluations and succession planning.

In the current environment, director succession planning is a requirement. For some institutions, that is simply a mandatory retirement age and, for other institutions, it is an evaluation of current director qualifications. Regardless of the process, simply allowing directors to remain "directors for life" is no longer acceptable. Periodic director evaluations, whether conducted internally or by a third-party advisor, are a useful way of ensuring everyone is focused on the shareholders and headed in the same direction. Additionally, engaging in succession planning helps keep the board focused. This process should analyze the current board structure, assess needs of the board, define qualifications for new directors, and identify potential candidates that meet the criteria. Effective succession planning not only assists the board in transitioning smoothly through changes, but also forces the board to put its current and long-term needs on paper and evaluate whether the current board measures up. That will be the sometimes difficult job for the Chairman to lead that discussion.

Beware of Cumulative Voting

Cumulative voting is intended to be a specific voting system that can be adopted by organizations to help strengthen the ability of minority shareholders to elect directors. If cumulative voting is permitted for an organization, then any stockholder may combine or "cumulate" all of the total voting power they have, and cast all such votes for one single candidate or spread them among candidates as they desire. Obviously, by doing so, the stockholder has a much stronger voting power, and may, therefore, as a minority stockholder, have a greater say in the affairs of the organization.

The mathematics of this is easily demonstrated with a simple example. Assume there are three directors of an organization to be elected and a stockholder owns 10 shares. Technically, that stockholder has 30 total votes because the stockholder can vote all 10 shares in favor of each of the three directors to be elected. However, with cumulative voting, the stockholder is permitted to combine the total voting power he or she has (in this example, 30 total votes) and rather than casting 10 votes for each director to be elected, the stockholder can divide the vote however the stockholder chooses, including casting all 30 votes for only one director, and not voting at all for the other two directors.

Therefore, the Chairman of the Board must be aware of whether the organization does or does not allow shareholders to have cumulative voting. Without proper attention to the possibility for cumulative voting, a minority stockholder with a relatively large block of shares may be able to put their own candidate on the Board that has not been recommended by the other directors, or even put themselves on the Board. So care would need to be taken to review corporate documentation as well as statutory provisions.

In most states, cumulative voting is either permitted or denied exclusively by statutory provisions, but, in all cases, allows the Articles of Incorporation and/or Bylaws of an organization to specifically define shareholder rights as it relates to cumulative voting. Care must be taken to review these provisions because in some states cumulative voting might have been permitted by statute unless denied in the Articles of Incorporation or Bylaws and, in other states, cumulative voting might be prohibited by statute unless authorized in the Articles and Bylaws. We have even seen a number of states where the applicability of cumulative voting is dependent upon when the corporate entity was organized because the laws may have changed and corporations organized before a certain date may have cumulative voting, whereas corporations organized after a certain date may not, or vice versa.

Calculation of Cumulative Voting Power

The simple example above helps demonstrate how shares are aggregated together. However, when dealing with actual numbers, the process can be a bit more cumbersome. As a result, there is a formula that can be utilized to help you easily determine how many total shares of stock a stockholder would be required to own in order to have the power to, on their own, elect a director, assuming they cumulate all of their shares and vote those shares for only one individual. The formula is as follows:

$$(S * X) / (D+1)$$

Where:

* represents multiplication

S equals the number of all shares voting to elect directors

X equals the number of directors a stockholder wants to elect

D equals the total number of directors up for election

Stated alternatively, the formula is:

> The total number of shares voting, multiplied by the number of directors I want to elect, with the product of that multiplication divided by the total number of directors up for election plus 1.

So, in the simple example above, where a stockholder owns 10 shares and there are three directors to be elected, assume the shareholder wants to ensure that he can elect one director, and assume there are a total of 100 shares voting. The math would be:

$$(100 * 1) / (3+1) = 25$$

Therefore, an individual would have to own more than 25 shares in order to be able to cumulate votes and elect one director. In this scenario where the stockholder only owns 10 shares, cumulative voting would still not guarantee that the person could put an individual on the Board.

Situations and Questions

While initially it seems like an easy straightforward calculation, the analysis can get a little complicated in real life situations. For example, normally, not all shares wind up voting at the election of directors, so you may not be able to calculate with certainty until shares are actually voted. In addition, as you can probably foresee, the individual calculations could be a bit cumbersome if some shareholders cumulate shares and vote them all in favor of one director, or other shareholders cumulate votes but spread them out over different directors, but less than all 10 directors, and still other shareholders simply cast the number of shares they own in favor of each of the directors. So, in any meeting where cumulative voting is expected to arise, the Chairman should ensure that someone is designated to handle the mathematics of the process and be prepared to calculate true voting power along the way.

The Chairman should be aware that cumulative voting rights only apply in the election of directors, and not in any other circumstances. It could be at an annual meeting for a normal election of directors, a special meeting to fill a vacancy, or otherwise, where cumulative voting is utilized, but it is only available for the election of directors.

Sometimes, your Articles of Incorporation or Bylaws may have provisions that are a bit in conflict with each other in an awkward way. For example, an individual might have the ability to exercise cumulative voting under statutory or corporate documentation provisions, but unless there are special provisions specifically prohibiting it, a majority of the Board of Directors might still be able to remove that board member with or without cause. So, each individual scenario would have to be reviewed against the current provisions of the Articles and Bylaws as well as statutory provisions and, as a result, you might want some outside legal assistance.

Meeting Adjourned

From the general to specific, the Chairman's role is constantly evolving in terms of the focuses for your membership. Keep these items in mind and, if you run into obstacles or if we can help in any way, please let us know.

Until next time,

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