The

Chairman's Forum

Opening the door to new ideas

Newsletter

Gerrish Smith Tuck, Consultants and Attorneys

March 2018

This is our first newsletter following the ICBA Annual Convention in Las Vegas. It was great seeing many of you there and we appreciate the kind comments we received from many of you, especially the time we were called "the newsletter guys". It is good to know someone is actually reading these materials. In this month's edition of *The Chairman's Forum Newsletter*, we look at a variety of circumstances coming out of clients we have recently dealt with, unusual comments from clients on particular transactions, we revisit the Wells Fargo situation and we look at how at least one bank cannot make up its mind on whether to split the roles of Chairman and CEO. We will provide some direction on all of those areas.

Recognize that for as many varied topics as we have each month in *The Chairman's Forum Newsletter*, that shows how much your role as Chairman of the Board continues to evolve and the way your Board members need to be in tune to the fact that being a Board member is not a mundane task you have to endure, rather it should be a vibrant business opportunity with great learning potential at every turn. If your directors do not view it that way, then let's begin to talk about director succession plans!

Happy Reading!

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Chairman's Summary

- Sometimes you need to educate the regulators.
- Say yes to strategic planning, regardless of the format.
- Learn from Wells Fargo: focus on what is important.
- Should you split the role of Chairman and CEO?

Beware of the New Application Analyst

As we enter a new cycle of bank growth and prosperity, many organizations are filing regulatory applications on what are otherwise fairly straightforward transactions such as acquisitions, branch purchases and sales, and related matters. Recently, though, we are finding that in this new cycle, there are a number of new applications analysts handling these functions for the various regulatory agencies and, quite candidly, they are going a bit overboard. So, your simple purchase of a small branch from a friendly competitor or other party may turn into a much more substantive and regulatorily burdensome transaction than you expected which, of course, drives the cost up.

We have seen recent circumstances on straightforward small branch acquisitions where, for example, the regulators were asking for items such as: a breakdown of deposits at each location (not just the one being acquired) including the total number of accounts and total dollar for deposits by zip code and account holder; a listing of non-financial entities such as credit unions, payday lenders and mortgage companies providing the most significant competition in the area (don't the agencies already have that information?); financial projections including risk-based asset projections for three years; projected liquidity ratios for three years; a listing of the types of programs, products and activities offered by the bank to justify its CRA rating of satisfactory (again if the regulators have rated it satisfactory, don't the regulators already have access to that information?); information indicating that the bank will continue to meet the needs of low to moderate income persons in the markets following the transaction (has a bank ever moved into a new market and immediately decided to stop serving low and moderate income persons?).

Again, it may be incumbent upon your organization, in consultation with its counsel, if it wants to engage in any typical transaction to have a bit of an education process for some of the new analysts coming on board as times improve. So, as Chairmen, beware that as the regulatory scrutiny increases, the costs will go up, even on typical transactions.

Is Strategic Planning Important?

Recently, we have given a number of presentations around the country generally along the theme of "asking the right strategic questions". The idea is to focus on the true relevance of strategic planning in the current environment. While most Board members agree that there needs to be a clear direction on where the organization is heading and in that sense there needs to be "strategic" planning, Board members may often differ on the relevance of doing it on a formal basis, bringing in an outside facilitator, taking a day or more of your time to work through the issues and handle similar functions. Often, we acknowledge that for many organizations strategic planning has, in fact, been a waste of time because the process has been handled incorrectly. As we often comment, if you are spending most of your time on "lingo-speak" where you are talking about your value proposition, your customer deliverables, your market-centric niche or other pretty language, you may be missing the boat of the substance of what you really need to discuss.

The Chairman's job is to ensure that the Board continues to focus on those things that are truly important. For some organizations, that really may mean trying to rediscover your mission or figure out what type of value you are seeking out. For many financial institutions, the Chairman's job will be to focus the organization on more tangible discussion items such as capital deployment, the merger and acquisition market, better use of the holding company to create shareholder value and similar substantive content.

Furthermore, it is totally appropriate to use the planning session as a way of taking the many unorganized and differing opinions of the Board, the management, your customers, stockholders, etc., and working to refine those into core strategies with a consensus of the Board of Directors. The Chairman should help his or her Board avoid the idea of needing to "get the house in order" before beginning the planning process. Rather, use the planning process to help get things in order.

Trust us, if you use an outside facilitator, they probably won't care that the "house is not totally in order". At least in our practice, those of us who handle multiple strategic planning sessions a year have seen just about everything in planning sessions from directors having a physical confrontation to people walking out of meetings to surprise announcements of retirements, tears, admission of activities that would get a person eventually fired and practically anything else you can imagine. So, letting someone else help you shift through the mess may prove more beneficial than handling it on your own.

Wells Fargo and Bank Directors

Earlier this year, the Federal Reserve issued an enforcement action against Wells Fargo and, in doing so, placed some of the bank's scandals squarely on the Board's shoulders. You may recall that Wells Fargo removed four Board members. Sometimes, these types of actions against Board members make existing Board members nervous that the potential liability of serving on a bank Board far outweighs any benefits. However, we have found over the years that the risk is manageable and that using these types of cases as learning experiences for how to improve governance of your own Board and to learn from the mistakes of others can be very helpful.

During the financial crisis, for example, when banks failed and even if directors were sued, we often instructed the Board members of healthy banks to read the lawsuits against those directors as a bit of a case study in how not to run your bank. Chairmen can learn a lot from the mistakes of others in guiding their own Board. In the situation with Wells Fargo, one of those learning lessons is that your directors need to be focused on the most important things, even if that means avoiding detailed review of the day-to-day mundane things. Consider that one of the regulatory maneuvers coming out of the Wells Fargo situation was streamlining what role those directors at bigger banks actually played. As was stated by the Federal Reserve, "*The intent is to enable directors to spend less board time on routine matters and more on core board responsibilities: overseeing management as they devise a clear and coherent direction for the firm, holding management accountable for the execution of that strategy, and ensuring the independence and stature of the risk management and internal audit functions*". So, we need to ensure that Board members are "majoring on the majors". That means ensuring your Board is not trying to micromanage the management team and rather focusing on the big picture elements of risk management, overall asset quality, strategic direction and overseeing and directing management.

More Chairmen and CEO Questions

Over the history of *The Chairman's Forum Newsletter*, we have occasionally addressed the issue of whether one person should hold both titles of Chairman of the Board and CEO. On a national level, this has been a debate that has ebbed and flowed with whatever the current economic, political and regulatory realities are. For example, when Wells Fargo got into trouble, what do you think was one of the first steps toward improved corporate governance it elected to undertake? Splitting the roles of Chairman and CEO. Likewise, during the financial crisis, other organizations such as Fifth Third separated the roles of Chairman and CEO. However, Fifth Third recently announced that they were, once again, going to combine the two roles. The former Chairman will remain on the Board and now be the "lead outside director". So, the question arises, if splitting the roles was a good decision during poor economic times, why would combining them be the appropriate corporate governance thing to do just because economic times are better?

At a community bank level, we recognize the realities that often one person holds the title of Chairman and CEO. That is not unusual and we do not necessarily think the roles need to be split. However, if the roles are combined, we do think it is a best corporate governance practice to appoint an outside director as the lead outside director and give him or her some authority. That authority might include the ability to call executive sessions anytime they want and exclude the Chairman/CEO from the discussion and take other similar steps. We certainly want to ensure that the Board has some level of independence from management since we are seeing the regulators demand more oversight of management, but in a way that avoids micromanaging. The best way to accomplish that is through a Board Chairman that is truly independent of management or at least where, if the roles are combined, a lead outside director is appointed from among the outside directors.

Meeting Adjourned

As Spring travel season is upon us, we look forward to seeing many of you at your banks or at the various conferences where we speak across the country. Even if you do not know us, we would welcome the opportunity to meet you, so do not hesitate to come up and introduce yourselves. In addition, if you have any anecdotal stories from your time as a Chairman or a director you would like to share with us, we would be happy to hear it. If you have specific questions, topics or issues you would like to have covered in future editions of *The Chairman's Forum Newsletter*, do not hesitate to drop us a note. We would love to hear from you.

Until next time,

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