The

Chairman's Forum

Opening the door to new ideas

Newsletter

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In this month's edition of *The Chairman's Forum Newsletter*, we take a little bit of a "back to basics" approach by looking at some of the core governance issues for your Board of Directors and ways to improve it. These governance issues include the total number of Board members and whether there is a perfect number or not. We also look at the role of inside versus outside Board members and what the structure of a proper Board might be. We look at the evolving role of directors and the role directors play in developing strategy versus management. We will briefly discuss legacy ways of doing things and whether those continue to be appropriate. We hope all of these areas help you improve your overall Board governance and we stand ready to help you on any and all matters or answer questions you may have.

Happy Reading!

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Chairman's Summary

- Have the appropriate number of Board members for your organization.
- Ensure the appropriate division of inside versus outside Board members.
- Don't get stuck in the past, update what you are doing.
- Directors should take charge of strategy.

Get the Right Number of Board Members

How many total individuals should serve on the Board of Directors? Further, should the number of Board members of my Holding Company be different than the number of members of my Bank Board? Sometimes it seems to fall to the Chairmen to set the number of directors and he or she typically does not really do that, but simply defaults to "whatever the Bylaws say." In fact, most Boards as a general principle tend to default to this idea that they are strictly required to constantly follow year in and year out what the absolute language in their Articles of Incorporation or Bylaws provide. For example, we have heard Chairmen say "it would be great to add two more Board members, but the Bylaws say we can only have nine." When we hear that, we simply respond "why don't you just amend the Bylaws to say that the number is now eleven." That comment is often met with somewhat of disbelief that the Board of Directors would have the authority to go in and modify this hallowed document first constructed by the town's founding father, Ebenezer Smart Money, in the 1930s!

Aside from obviously being tongue and cheek, the point is that the corporate documents are there to provide the basic guidelines for how the organization should function. However, they are not intended to be a handcuff that keeps the organization from evolving, changing, and modernizing itself as needed. It is normally a relatively simple procedure to amend your Articles of Incorporation or Bylaws to meet your current needs and, if one of those is a limitation on Board members, consider making that change. If an amendment has to be made to the Articles of Incorporation, it may require shareholder approval, but often the Board of Directors can amend the Bylaws without shareholder approval.

Most Boards are hesitant to add more Board members, not because they do not really need more Board members (they do), but because of fear of what the documents say or for some other silly notion such as "will have to add chairs to the boardroom." However, if you are paying exorbitant Board fees, it certainly can add to the cost to add more Board members. As Chairmen, ensure that you have the proper number of Board members to conduct the business that you need to conduct. If you are operating with the same number of directors you always have, consider a change.

Inside Versus Outside Directors

As a general corporate governance rule, you are probably aware that at least a majority of the Board should generally be comprised of independent outside directors. The idea is that if "insiders" (officers and large stockholders) make up a majority of the Board of Directors, they might have a tendency to seek to influence policies and procedures in a way that is detrimental to other stockholders, other depositors, and it does not provide an appropriate check and balance against management operations. But, does that mean your organization should have no insiders (perhaps other than the President)? We are seeing more organizations considering the addition of more officers to serve on the Board of Directors because of their knowledge and expertise. We generally see no problem with that, provided, again, that the outside directors are strong, independent-minded, and willing to challenge management where needed. The important thing is to have a Board of Directors that exercises its fiduciary duties and fulfills obligations to shareholders, so some balance of insiders versus outsiders, with at least a majority being independent outside directors, works well. In the U.K., there is a corporate governance code that indicates that directors are presumed to lose their status as outside independent directors after they have served for nine years on a Board of Directors. Ask yourself, if my directors were no longer deemed to be outsiders after serving for more than a decade, would I have any outside directors? That may not necessarily be a good rule of thumb for us in the U.S., but what if we doubled the standard and said that you lose your independent status once you serve 20 years? Our guess is that many of you would still wind up with no outside directors.

Force Change

Are you driving the same car that you did in 1970? Are you wearing the same clothes? Are you getting your news the same way? Do customers handle their banking transactions the same way? If you notice that in any of those areas times have changed and things have evolved, then why would you continue to have Board governance practices that are 100% exactly the same as they were in 1970? As Chairmen, you may have to take a tough look at what you are doing and force change upon your Board whether they like it or not. Adding a new component to your agenda or, better yet, make the first item of business discussion of strategic planning, rather than review of minutes. Whatever it is, do something to force change upon your Board as a way of revitalizing them. A recent situation we encountered was a Board of Directors that was meeting more frequently than once a month. When asked why they were meeting so many times a month, their answer was that in the 1970s the Bank got into some regulatory trouble and, therefore, needed to meet on a more frequent basis to work out of the problems and they have just kept doing it ever since. Does that make sense? The point is that, as Chairmen, you cannot allow your organizations to fall into any sort of rut, whether it is the number of times a month you meet, the way your agenda is handled, even where members sit during Board meetings. Create an environment where change is welcomed, where it is exciting, where it can even be funny. If you are not sure what change to start with, try this. At the next Board meeting, arrive early and go and sit at the middle of the table, rather than sitting at one end where a Chairman would normally sit. If this causes your Board hours of discussion, you perhaps have a Board resistant to change!

The Board Directs Strategy

We were recently reading about some of the continuing issues facing Wells Fargo in the aftermath of some of the problems they have encountered. In one of the recent commentaries it was pointed out that the regulatory agencies had impressed upon the Board of Directors the need to take a much stronger leadership position when it came to strategy and implementation of risk tolerance policies. In fact, it was described as the Board needing to take more "ownership" of those issues. Far too often we see the highest level strategic decisions left exclusively to the management team, where the Board is merely asked to ratify or rubberstamp what the management team is doing. On the other hand, though, it would also be wrong for the Board of Directors to take sole responsibility for strategic direction and risk management practices of the organization. Rather, a collaborative effort is needed, with the management providing the banking expertise on those areas and the independent Board members providing oversight, entrepreneurial vision, and direction for the benefit of overall shareholder value. Neither party should dominate the other when it comes to strategic planning.

So, as Chairmen, lead that collaborative effort; work closely with your senior management officials; ensure that everyone is on the same page with a clear vision of where the organization wants to go; and, at the Board level, set the expectations in collaboration with the management team. Then, having taken ownership of the strategic planning role and working collaboratively with the management team to come up with the direction that is needed, the Board should step out of the way and give management the full authority to implement those strategic initiatives.

Meeting Adjourned

There is a saying that what is old is new again. We are not so sure that applies in banking. What's new is what's new again. So, as Chairmen, you may need to force change, you may need to continue to focus on inside versus outside directors, you may need to ensure that your Board is truly taking ownership of the strategic initiatives of the organization. Additionally, as Chairmen we perhaps do not need to be bound by antiquated provisions in our Charters and Bylaws that are hindering our development rather than promoting development, such as limitations on numbers of Board members. Make sure those corporate documents remain fresh as well. In all of these areas, strive to keep your organization moving forward for shareholder value. If we can ever help, let us know.

Until next time,

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