THE

Board Chair Forum

NEWSLETTER

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys

December 2020

Well, we are (finally) coming to the end of 2020. While it has presented a host of challenges on a national, international and more local level related to the pandemic - social causes, Presidential politics and other factors - there are still many blessings to be found and positives for the financial institution industry. As leaders of your organizations, as the Board Chair, board members or executive management, you have probably faced issues, concerns and difficult decisions you never envisioned in January. However, across the board we have found a resiliency of leadership and a willingness of those who follow to be adaptive, flexible, and just as hardworking, even when doing so in their pajamas from the kitchen table because of remote work requirements. We think the lessons in leadership learned in 2020 will continue to serve the industry well into 2021 as we continue in a recovery mode from the most unusual of circumstances. We believe leaders will continue to balance a focus on core underlying principles of running the financial institution on a traditional basis with an acknowledgement of the pressing need to continue embracing new changes, new technology, new ways of working, and other modifications, all with the goal of achieving the same result of increasing value.

We hope that the Board Chair Forum Newsletter has been helpful in all of those areas and in this month's edition, the final of 2020, we take another look at some key issues as we cross from 2020 to 2021. Our entire team wishes you a Merry Christmas, Happy Holidays, and a prosperous New Year.

Happy Reading!

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Board Chair's Summary

- Deal Smartly with Regulators, Not Out of Fear
- How to Make Strategic Planning Work
- Mandatory Retirement vs. Board Evaluation

Deal Smartly with Regulators, Not Out of Fear

Perhaps not surprisingly, we are beginning to see the first evidences of increased regulatory scrutiny, asset quality problems, and other regulatory concerns. Moreover, we are also hearing our regulatory friends beginning to sound some preliminary warning bells that into the second half of 2021, more regulatory problems may begin to rear their head. Therefore, as a leader of your organization, and for many of you recalling past downturns in the economy and asset quality problems, it is important to be ahead of the curve in managing the organization appropriately, including how you deal with regulatory personnel.

It should go without saying, but we will still say it - openness, honesty, directness and transparency are of vital importance. Not only is it the right thing to do in a general sense, but it is important to take that approach because of the impact it has on the regulators. In essence, it is arguably better to have a host of problems and to be open, honest and direct with the regulators, than to have a few critical issues but where you try to shade the truth or not be fully engaging with the regulators about the problems. The reason for that posture is because frankness with regulatory personnel goes a long way toward fostering management's credibility, which has a direct impact on the regulators' view of whether management has the willingness and capability to clean up the problems, and in turn, directly impacts the "M" component of your CAMELS ratings, which is critically important since that element includes both the Board and management. It may come as a surprise, but it is not shocking to regulatory personnel if a bank has problems. All banks are subject to encountering problems somewhere along the way. The thing that distinguishes one bank from the other, though, is how they deal with it. Does the board acknowledge problems, tackle them head-on and begin the process of trying to fix the problems, even if that means fixing them by complying with an MOU or a Consent Order? Over the past 30 years we have found that the organizations which address their problems upfront and candidly, typically wind up with a less invasive enforcement action, if they are to receive one, and more leniency by the regulators in agreeing to appropriate bank requests. Therefore, if your management team has credibility, then you should not hesitate to negotiate with the regulators on key provisions of a proposed MOU or Consent Order. You do not have to sign a document with which you are unable to comply or which is unduly burdensome. But a candid discussion with regulatory personnel is appropriate in that regard. You should not operate out of a position of fear of engaging your regulatory personnel. After all, you are the one running the bank along with the other bank leaders, not the regulatory personnel. You should know the bank better than they do. But it is when you demonstrate a lack of concern for their recommendations, suggestions or mandates that then management loses credibility as well.

We are beginning to work with a number of banks who have a few “soft” regulatory problems and this advice is what we always provide to them. As we help them review and negotiate documents, we find this approach results in the best outcome for the bank and allows them to comply with any type of order as quickly as possible, which ultimately is the goal of both the regulators and the bank. If you run into that scenario, keep these thoughts in mind and let us know if we can help.

Making Strategic Planning Work

As we close out the fall strategic planning season, it is always an interesting time for us because we are in the process of writing reports for those organizations that did planning in the fall, and yet we are also beginning to field calls for entities that like to do their strategic planning in the spring. As a result, we have had the opportunity recently to deliver a couple of presentations about strategic planning on an interesting thought, which is centered around the concept of "Strategic Planning When Your Plans No Longer Work." Obviously, for many of us, the plans we made in 2019 for how to go in 2020 went right out the window around March 15th, and we basically engaged in daily updated strategic planning as new challenges seemed to be coming at us minute by minute. So when your old plans don't work, what do you do?

We posed a relatively straightforward (and not too earthshattering) answer. The answer is, change your strategic plans and change your process. In taking this approach, the idea was to emphasize that strategic plans are not static documents that lock you into a forced pattern of activity. Rather, dynamic institutions make dynamic changes and if you believe your strategic plan is a rigid, inflexible document that must be met to the letter of the law, a year like 2020 should have demonstrated the fallacy of that belief.

Therefore, we have been challenging our clients to think about strategic planning as really a system of asking and answering the right strategic questions. We also suggest that the types of strategic questions you should be asking sound nothing like what the textbook says should be the type of strategic question you ask. Those wrong strategic questions are things like "What is your value proposition?" "What are the deliverables?" "What is our ABC quotient?" Rather, try these more direct and hard-hitting questions: When are we going to sell the bank? If the answer is "never," how do we keep it independent? We have an aging shareholder base with many stockholders wanting liquidity. How are we going to afford to pay them out without having to sell the bank? Our main office is in a rural market. How do we continue to attract and retain top talent? Should we consider relocating the corporate offices to our growth areas which are more metropolitan? Why are we talking about buying another bank if there is still market share to be harvested at our current locations? Why do we continue to provide products and services that add absolutely no monetary value to the bottom line? Why do we continue to retain branch locations that are not profitable when other organizations are closing branches and reinvesting in technology?

You see the process of strategic planning is not about checking the boxes from some consultant's 12 page matrix with arrows, diagrams and boxes. It is about simply addressing the most critical issues impacting your bank and ensuring that your decisions move the organization forward in the direction you intend it to go. Don't complicate the process more than it needs to be. But call if you need help!

Mandatory Retirement vs. Board Evaluation

We have recently had the opportunity to speak with multiple banks in different parts of the country, both as part of their planning process and independently, about the topic of board succession planning. For many organizations, they simply point to the requirement in the bylaws for mandatory retirement once a director reaches a specified age. Therefore, they claim, they already have a process in place and there is no need to talk about board succession. Not surprisingly, though, to many of you, when we hear that, we have a tendency to look around the boardroom and, without being judgmental, notice that a few of the directors may not have read the bylaws recently because they seem to have passed the age "suggested" on page 9, section 6, subparagraph 3. If we inquire about that, we often find that the answer is that the one or more individuals on the board who appear to be older than the stated age are, in fact, older because they have simply been "grandfathered" under the provision. So, do you really have mandatory retirement if you don't really use mandatory retirement? Our recommendation would be to use it or get rid of it. Going further, we are not proponents of mandatory retirement ages in and of themselves. We know of some awesome directors that are in their eighties and a few even in their early nineties. What we do suggest is that if you do not use mandatory retirement, you still need a process to ensure board succession and ensuring that your directors are staying active, engaged and involved, regardless of their age. That obligation to direct the organization on board succession often falls to the Board Chair. In that regard, we would recommend eliminating mandatory retirement but moving to an evaluation system of directors.

Evaluating directors can be difficult and we do not recommend, if you have never engaged in that process, immediately beginning a peer-to-peer evaluation where everyone is pointing a finger at everyone else and judging them on how effective they are as a director. Rather, a multi-step program is generally preferred. A board might begin the process of board evaluations by evaluating how the board functions as a unit, do they receive appropriate information from management, are the board meetings structured appropriately, etc. In essence, it is a bit of a corporate governance analysis.

A second step, after evaluating the organizational unit (perhaps even six months or a year later) would be a self-evaluation process. This is often done by initially outlining the key attributes a director should possess (business development capabilities, ability to attend meetings in person and participate, the director's role in the community, etc.). Therefore, a questionnaire or other evaluation tool can be developed to allow a director to scrutinize his or her own performance over the past year or past month, against the expectations for directors. Oftentimes, this self-reflection can jumpstart the director to being a better director overall.

Another step, then, is ultimately to migrate to a fully engaged board evaluation process that may involve elements of the first two steps and also a peer-to-peer evaluation. The ultimate goal of that may be to have each director confidentially rate the other directors and answer the question of whether the director being rated should be available to be reelected at the next annual meeting.

There are other issues that come into play off of that overall structure with regard to the Nominating Committee, addressing who evaluates the Board Chair, what do you do with the results of the questionnaires (is an outside party, like our firm, brought in to assess those and discuss those with the directors), and other factors. In addition, in any of the other prior steps you might also take time to have the Board Chair or a Lead Director sit down with each person and review the self-evaluations or the peer-to-peer evaluations, or take similar steps. Likewise, the evaluation process itself can take on a number of different variables, may ask different types of questions, or may be utilized at different times throughout the year. The key is to make it appropriate for your organization. So, as you confront the question of board succession now or into the new year, recognize that the obligation to deal with the succession issue is that of the Board Chair, and give some consideration to the balance of a mandatory retirement age versus having a board evaluation process, and structuring something that works appropriately for your organization.

Meeting Adjourned

Congratulations on surviving 2020! We looked back at the January edition of the Newsletter and it did not even mention COVID at all or how to respond to it. But, it did suggest that financial institutions were still poised to thrive in 2020, and notwithstanding all of the headwinds, we continue to believe that to be the case in the coming year. Things certainly have changed and will continue to change, but the fundamental principles of leadership apply in times of both prosperity and crisis.

As we depart 2020 for a new horizon, we are thankful for our clients, friends, and all of you who make the financial services industry possible. We truly are honored that you take the time to read our publications and engage our firm for services as needed, and we appreciate both your business and your friendship. We look forward to hearing from many of you in the new year, and look forward to renewing acquaintances either in person (fingers crossed) or on the next version of video conferencing and video chatting!

Wishing you all a Merry Christmas, Happy Holidays, and a Prosperous New Year!

Until next year,

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