THE
Board Chair Forum
NEWSLETTER

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys

March 2022

The past several weeks we have been involved in numerous different kinds of Board of Directors meetings where multiple governance issues were discussed. These discussions included whether to eliminate mandatory retirement, whether to initiate mandatory retirement, sorting out how to resolve board difficulties, how to best plan for board succession and a host of related items. All of those point out emerging issues for the Board Chair and Directors in general. In this month's edition of the *Board Chair Forum Newsletter*, we try to tackle some of those issues and provide alternatives that might be appropriate in any given situation, although no two banks are the same. No two banks are the same.

As we move into the spring strategic planning session and spring annual meeting timeframe, we hope many of you are beginning to experience some warmer weather and are looking forward to the summer months for your organization and yourself personally.

Happy Reading!

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Board Chair's Summary

- ***Should you rethink mandatory retirement?***
- ***Are staggered board terms really needed?***
- ***What can FedEx teach us about succession planning?***
- ***Don't Ignore Board Problems***

Should You Rethink Mandatory Retirement?

Should your organization have mandatory retirement? We have two responses for you. Yes and no. Which answer is right for your organization depends on what else the organization does. Maybe we should boil it down this way, every organization needs to maintain the "best and brightest" as your directors. That is simple to say. The next logical question that follows, though, is how do we determine if we have the best directors? The easy response is you evaluate them against the list of job requirements or director expectations that you have developed for them, you cover with them each year where they have fallen short and where they have succeeded, and the board periodically takes time to update, revise and evolve the list of expectations. So, see it is simple.

If you have done all of those things then, no, you do not need mandatory retirement. If a director who is turning 75 can no longer meet the expectations, then he or she will not be renominated to serve on the board. However, the same holds true for the 45 year old director. If he or she is unable to meet the expectations or fulfill the job duty requirements he or she will not be renominated. It is as simple as that. But, for many of you reading this you do not have that type of objective evaluation system related to your directors. Instead, many of our client's default to the "fuzzy" standard of "I'll know when I can no longer serve or when it is my time and I will voluntarily elect to not sit for reelection". Really? Then why do we keep having these problems over and over in boardrooms? The truth is, at the point where I am finally willing to admit that I can no longer serve as a effective board member and I agree not to set for reelection, the remainder of the board may have thought that for the past ten years!

It is not an issue unique to your bank. All boards are struggling with this because all of us want to continue to feel useful for as long as possible. But the reality is that those are difficult conversations. So, if you are willing to admit the difficulty of those kind of discussions and the difficulty your organization would have in conducting those discussions or that type evaluation, then the answer is yes, you need mandatory retirement. By far, it may not be the best mechanism for director succession but it sure is an effective one that draws a clear line in the sand. But, you know what often happens? We take a clearly defined standard that has been previously approved by the Board of Directors and when it comes time to use it, we get "weak in the knees". So, the board decides to make a one-time exception for that director who has finally reached the mandatory retirement age since she is still very sharp and an active contributor to the board. We cannot lose her wealth of knowledge and information and long history of knowledge of the organization just because she has reached a certain age. So, we make an exception for her. Most of the time that exception is 100% warranted. The problem is when the next director who does not possess the same sharp mental faculties reaches retirement age, in order to be "fair" we let him or her stay on the board as well. Then we effectively do not have mandatory retirement and our process repeats itself over and over.

So, we have shown you how the correct answer can be yes or no. Practically speaking, many boards who have some element of mandatory retirement think of it in an entirely wrong way. In essence, the organization begins to think of it as the maximum time that you can serve unless you die first. So, you either die or reach the age requirement. It does not matter if you are really performing well or not, you are in essence guaranteed your seat until your death or until attaining the mandatory retirement age. We believe, rather, you should be looking at mandatory retirement as one item in a list of minimum expectations for directors. As part of that process, maybe your organization takes the position that a director can no longer be elected to serve as a board member if the person is not doing the outlined things (participating in meetings, maintaining some minimum director education, attending a certain number of meetings in person, attempting to refer business to the bank, etc.) <u>or</u> you have reached a certain age. In either case, you can no longer be renominated. So, perhaps it is time to rethink how you are using mandatory retirement or whether you should start reusing it or whether you need to eliminate using it.

Are Staggered Board Terms Really Needed?

In a recent board situation where we were providing some consulting services to the community bank there was some confusion in the corporate documents about mandatory retirement and the terms of directors. This organization, like many organizations had classes of directors or what are often called "staggered" directors whereby only a certain number of directors are subject to reelection each year, but when they are reelected, they are reelected normally for three-year terms. The idea behind this corporate structuring of the board is to prevent the entire Board of Directors from being eliminated or removed in a single annual or special shareholders meeting. The idea is that it is a bit of an anti-takeover mechanism so that anyone wanting to try to use their power to remove directors can only do it over three years. The entire board cannot be replaced at one annual meeting.

If your organization has a mandatory retirement age, is the person required to retire as soon as they reach that age or, if they have been selected for a longer term of office can they serve beyond the mandatory retirement age at least until the end of their term? You might check to make sure you do not have that kind of conflict in your organizational documents and make sure it clearly defines whether a director reaching mandatory retirement age is permitted to serve out the term to which she is elected or if she must retire immediately.

You can see how that might present a difficult situation. A director finally reaches mandatory retirement age but the annual meeting is going to be held a month before that age. Arguably the director could then sit for reelection and serve for another three years. This has many organizations rethinking the actual need for a board divided into classes or otherwise being "staggered".

Is there any real threat that someone is going to come in and vote to eliminate the entire Board of Directors in one meeting? Candidly, in over 30 years we have never seen that fully happen? Maybe if you are going to maintain an aging board it would be better to have them subject to reelection and reevaluation every year rather than automatically granting a three-year term at a time in which health issues can change quickly and dramatically. It certainly is something to keep in mind. During the drafting of this newsletter, Banner Corp in Washington state announced that the board had approved an amendment to eliminate staggered terms for directors and to provide for the annual election of all directors. So, in addition to pointing out how timely our newsletter is (pat on the back), it shows that more organizations are looking at this option. In the press release related to this organization, it was indicated that the change in board structure will "promote accountability by electing all directors annually". These types of initiatives are often shareholder driven or at least are intended to promote better shareholder relations.

What Can FedEx Teach Us About Succession Planning?

The Founder, Chairman, and CEO of FedEx Corp, Fred Smith, recently announced that he is planning to step down from the CEO role. We believe the manner in which he chose to do so and some of his comments have bearing on some of the similar succession issues many of our clients face. Interestingly, since the company's founding in 1971, succession planning has been a focus of the organization.

According to recent published information, the succession plan, which is to take effect beginning with fiscal year 2023, was put in place in 2019. Would your organization begin succession planning three to four years in advance? Time goes by faster than you think. Interestingly, the FedEx board even took the step of appointing the successor immediately to take over at the designated point in the future. So you officially have someone in the role, for example of a CEO-elect. We often don't do that in the banking world, but should we consider a board chair-elect, a CEO-elect, a president-elect, etc.? The stability that may provide to our employees or to our markets if we are publicly traded may be important.

FedEx also took this opportunity to appoint a non-executive vice chair of the board who will become the designated successor to the board chair role at some point in the future. Again, that is best practice for a publicly-reporting company and not something required for private companies, but something we might think about as good corporate governance. FedEx is always regarded as one of the best run companies and their role in planning succession in making a smooth transition bears that out. There are lessons in there for all of us.

Don’t Ignore Board Problems

We would all like for our boards to run smoothly with no technical or personal issues. However, that is not always easy to achieve. However, it is probably a worse sin to ignore the problems than to admit that you have them.

If you have been keeping an eye on any of the headlines recently, you have seen where some high profile, publicly reporting boards of directors have gotten crossways with each other. In one case, the board chair began publicly airing disagreements with the bank’s leadership and strategy. The chairman expressed “extraordinary disappointment” with the organization’s financial performance and management’s “apparent inability to develop, articulate and follow a strategy that is designed to improve total return to stockholders”. Wow! Nice to have your board chair putting that in the press for everyone isn’t it? As you might imagine, the rest of the board did not particularly care for that type of airing of their public grievances and, as a result, they voted to remove the board chair. Interestingly, the individual will continue to serve as a director. However, the company put out a statement indicating that the individual was no longer best positioned to serve as the board chair. In that situation, the director who was removed had somewhat aligned himself with one of the activist shareholder groups of the organization who was suggesting that the organization consider selling the bank. For most of our clients we don’t have that type of public grievances, but the issues are no different. One or more directors who are friends with one or more stockholders may want to sell the bank while other board members don’t. There may be family disagreements. The longer those items remain unaddressed, normally the worse the problem becomes.

If you are in a position of a board chair and you know your organization has these types of disagreements, understand that they rarely go away on their own. Direct and open discussion is often the best route to resolution, provide as much transparency as possible and get all the issues on the table, then everyone can work toward a common resolution, or at least an open recognition of what the issues are and why they disagree.

Meeting Adjourned

Things still remain very active around the country on a host of fronts and we will continue to send you the interesting information we find in our travels. We will have another *Board Chair Forum Newsletter* to you soon and in the meantime, if we can be of assistance please don't hesitate to reach out to us. We look forward to hearing from you.

Until next time,

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