THE

Board Chair Forum

Opening the door to new ideas

NEWSLETTER

Gerrish Smith Tuck, Consultants and Attorneys

June 2022

Is summer really here? Just in the past week we have been in parts of the country where it was 53 degrees, overcast, cold, and rainy, and the following day in another part of the country where the total heat index was 104! So, as they say, change comes at you fast. The same can be said to be true of our boards of directors.

Over the past several weeks we have had the opportunity to speak to boards of directors at planning sessions and to speak at some conferences around the general theme of "Building a Better Board." We always find this type of discussion, along with the feedback from directors and the Board Chair, to be very engaging and to hear about the constant ways that boards are looking to shake things up, and truly strive to be a better board.

In this month's edition of *The Board Chair Forum Newsletter*, we look at some of those ways we can improve on being a better board and highlight some recent issues boards have confronted and how they dealt with them. We hope you will find these comments helpful as you continue your service as a board member and continue to look for ways to strengthen your organization.

Happy Reading!

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Board Chair's Summary

- *Fiduciary Duties Change in M&A*
- *Use Your Committees Appropriately*
- *Micromanagement and the Difference in What or How*
- *Revisit the Public versus Private Structure*

Fiduciary Duties Change in M&A

Recently we were giving a presentation and made a comment that a board of directors, when considering some type of merger or acquisition transaction, is subject to "heightened duties." A director in the audience asked a pretty good question which was, "What does that mean?" Perhaps too often we tend to gloss over those kinds of catch phrases without really taking the time to think about what they mean or to explain them from a legal standpoint. So here is what you need to know.

When we talk about directors having heightened duties, think of it from the standpoint of meaning that your actions are much more likely to be criticized. Directors could certainly be sued for selling a bank too cheaply. Directors could be sued for failing to accept a really good offer that shareholders thought they should receive. Directors could certainly be criticized for the way in which they evaluate a transaction, or if it looks like there is some kind of benefit the directors are getting that other shareholders are not getting. In essence, there are a myriad of different kinds of challenges that outsider groups or shareholders could make against a board of directors when it thinks about engaging in a buy or sell process. So, the obligations and the duties of the directors are "heightened."

The way we fulfill those heightened duties normally means we go the extra step to make sure our board minutes fully document what we are doing. We avoid even the appearance of impropriety in voting or taking certain actions, excluding directors, or asking directors to not vote if they have a conflict, and other types of additional steps. We, in essence, want to make sure we have appropriate documentation in terms of what we are doing, which may include board resolutions, it may mean appointing a particular M&A Committee, and overall, it means following a defined process and plan for what we are doing so that we check all the boxes along the way as we consider buying or selling, knowing that our actions could be subject to more scrutiny.

Use Your Committees Appropriately

Part of the job in building a better board is to make sure your committee structure is set appropriately. But how many committees should you have, who should serve on them, should you rotate positions, etc.? No two organizations do it the same, but you might consider some fundamental guidelines.

In terms of trying to figure out how many committees to have, we had one client who took an approach of looking at "reverse engineering." In essence, they decided how many total board members they should have based on how many committees they needed and how they wanted to populate those. That is contrary to the way most banks do it, which is to decide how many directors they want to have, and then put those directors on however many committees they develop. It is a novel approach to looking at committee structure, but maybe one that might work for some organizations.

In terms of the types of committees, we are certainly seeing across the country more emphasis on issues of corporate governance impacting the types of committees that are established and the way they are established. For example, privately held companies might have an Audit Committee, but corporate governance rules applicable to public companies that would require the entire committee to be composed of outside directors, do not generally apply the same way to privately held organizations. The general rules say that for organizations between $500 million and $1 billion the member of the Audit Committee must be outside directors the majority of whom are independent of management. For organizations over $1 billion all members of the Audit Committee are to be outside directors who are independent of management. Yet, we see more organizations that are privately held, even some under $500 million, working to ensure that the Audit Committee is comprised only of outside directors as a type of best practice. Similarly, many smaller organizations do not really operate with a true Nominating Committee. Rather, the directors simply reappoint themselves every year. But then those same organizations complain that they have board members who are not engaged, don't fulfill their fiduciary obligations, etc. So, in addition to having a board evaluation process, a list of board expectations, or perhaps even some type of mandatory retirement system, utilizing an actual true Nominating Committee to determine what individuals are going to be nominated to serve on the board during the next term (with some expectations or other predetermined criteria set up to measure directors against) would certainly be a best practice.

We also recently received a question from a board member who asked whether it is better to have committees comprised of individuals with expertise in those particular areas, and keep those committees constant, or whether it is better to rotate board members so that each board member gets a taste of each committee and builds their own knowledge going forward. Both practices can be beneficial, but generally speaking, we believe the healthiest boards use some combination by perhaps having a fairly consistent board chair of each committee that brings certain expertise to that committee, yet has a continuing rotation of different members coming in and out of the committee, so that all board members are versed in all areas of the organization.

Micromanagement and the Difference in What or How

Board members constantly hear that they should not micromanage. As we often say, not only should directors not micromanage, they shouldn't macromanage either. Directors direct, managers manage – it's pretty simple. Or is it? Allow your organization to get into a little bit of regulatory trouble, and our friends the regulators will all but come in yelling at the directors for not being involved enough, not taking as much of an active role, not providing enough oversight and direction to management, allowing management to do whatever they want without criticism from the board, etc. So, the natural kneejerk reaction of the directors is to then become more involved and that often leads to micromanagement. So how do we avoid that problem?

Generally speaking, this is where we try to define the director's roles separately from the roles of the management team by distinguishing between what should be done and how it should be done. This often comes up in the context of strategic planning retreats we are conducting where the primary focus of the retreat needs to be the 30,000 foot focus on defining what needs to be done in terms of organizational objectives, and what direction generally the organization should go, but while leaving the more operational aspects of defining how to get things done and the specific steps to be taken to accomplish those objectives to the management team. Therefore, if you are wrestling with these concepts of how to draw the line between the board's role and management's role, in an oversimplified fashion, you might say that the board of directors is charged with deciding what needs to be done, in consultation with management, and then the management team is in charge of deciding how it should be done, in consultation with the board.

Revisit the Public versus Private Structure

Part of the directors' obligation of building a better board is to make sure that the board has the tools at its disposal to make the critical decisions for the organization. Often, that may mean arming the board with more information and education and we hope our firm's newsletters help in that regard. As part of that, we would encourage boards of public companies that are SEC reporting to periodically revisit that structure to determine if it is the best structure for your organization.

As we travel around the country, far too often we see relatively small organizations (for example, those under $3 billion in total assets) that have a fairly small stockholder base (at most, perhaps 1,000 to 2,000 stockholders) who are fully SEC registered companies filing 10Ks, 10Qs, and having their stock listed on an exchange. Most of those companies do so in the belief that it inherently creates liquidity in the stock. The idea of liquidity is based on the idea that there are plenty of buyers and sellers, and creating that liquidity is worth the headache of all of the public reporting and document filing that is required to have the benefit of the public market. Yet, many of those organizations find that they have a host of days where there is no trading in their stock at all, or they wonder why the "market value" of their stock is really no more than the book value of the stock, or may even be less than the book value of the stock.

Therefore, it is important for the board to question whether public company status is appropriate for your organization or whether you can achieve the same levels of liquidity and better control your own stock value by being private and utilizing your holding company to repurchase shares and conduct similar activities. This thought about potentially converting from public to private status might be expedited given some of the recent SEC climate proposals that seem to rachet up the costs of reporting and potential liabilities associated with being public. For example, is your community bank prepared to collect Scope 3 greenhouse gas emissions data directly from your customers? Do you even know what that is? Are you prepared to include climate-related disclosures in your registration statements and your periodic reports? Focusing on the comments above about your committee structure, are you prepared to develop a climate-related committee for risk management purposes, and do you have expertise on your board regarding climate change, greenhouse gas emissions, carbon footprints, and the like? The point of all of this is not to suggest that public company status is necessarily bad, but to encourage smaller organizations with a limited stockholder base to question whether they are really getting the upside benefit of public company status, or whether it is time to rethink a going private transaction given the likely increase burden there will continue to be on public companies. If we can help you consider the alternatives, please let us know.

Meeting Adjourned

Notwithstanding the cool weather we recently encountered, it does seem most places are heating up, so we hope you find nice days ahead, we hope you find some kernels of information in this material that will be helpful to your organization, and we hope, overall, that you are able to continue the process of "Building a Better Board." Anytime we can be of assistance to you in those endeavors, please don't hesitate to reach out to us.

Until next time,

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