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Dave Bochnowski, Peoples Bank, Munster, honors his family banking heritage. A board room portrait portrays his father, the late Ben Bochnowski.

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Corporate Governance: How to Act in a Post-Bailout Era

CATHERINE A. GHIGLIERI
Ghiglieri & Company

"Corporate governance" refers to the manner in which a company is directed by its board of directors. With the collapse of such companies as Enron, WorldCom and others, there has been greater scrutiny of corporate governance and the manner in which boards of directors make decisions affecting their companies.

The Sarbanes-Oxley Act was passed in 2002 with the goal of restoring the public's confidence in the corporate governance of public companies. As a result, there are many corporate governance requirements for public companies that serve as best practices for private companies, including banks.

Corporate governance is perhaps more important today than ever. The public's perception of banking is arguably more negative today than in years past. A 2009 Harris Poll asking whether certain industries do a good job or a bad job of serving their customers revealed that almost 40 percent of those surveyed felt that banks do a bad job. Bailouts of some of the largest financial institutions last year and increased bank closings this year no doubt contributed to this negative view.

One of the best ways to combat this overall negative image and to make sound decisions is by implementing good corporate governance practices. To put these corporate governance practices into context, remember that board members have a duty of care to exercise the same level of care in making decisions for the bank that an ordinary person would use in making his or her own personal or business decisions.

This expectation means that board members are to attend the board meetings, actively participate in those meetings by asking questions, be informed about what is being discussed and exercise independent judgment. Good corporate governance practices can help board members fulfill their duty of care, as well as help them make sound decisions.

Following are seven suggestions to improve bank corporate governance:

1. Select an outside chairman of the board. More and more boards are going to an outside chairman of the board, who is neither a bank officer nor related to the bank chief executive officer. Having an outside chairman can prevent the board from being dominated by one person and provide an atmosphere for input by all board members.

2. Distribute board packets in advance. Banks have various means of providing information to their board members, ranging from requiring board members to come into the bank to review the board packets, to e-mailing the board packet to them in advance of the meeting. Prior to e-mailing the board packets, an analysis of the security of e-mail should be made, as well as the sensitivity of the board information. Rather than e-mail the board packets, some banks make them available by having board members log on to a secure portion of the bank's website and review or print off the packets.

While there is no one right way to provide information to the board prior to the meetings, board packets should *never* be handed out at the board meetings. Distributing information to directors in this manner does not allow ample time for reading the information, formulating an opinion and being prepared for appropriate discussion. In order for the directors to fulfill their duty of care, they need to be prepared for the board meetings, which means they need to read the board packet prior to the board meeting. Ideally the board packet should be sent to the board members a week prior to the board meeting to allow for thoughtful reflection.

3. Review board packets for relevance. Many board packets contain the same information that they did 25 years ago.

As regulators have required directors to review additional information over the years, board packets have grown to include this information—but rarely is anything deleted. The board packets in many banks have become unwieldy, weighted with unnecessary information.

An objective review of the board packet will ensure that the information provided to members is relevant to board discussions, considering the size and condition of the bank. For example the directors may be reviewing each overdraft on a given date, as the board did when the bank was $25 million in assets. But now that the bank is $250 million in assets, it might be time to streamline this report to include only the large overdrafts. Or rather than reviewing each loan made in a given month, the report could be streamlined to reflect only those loans exceeding a threshold dollar amount.

When the board packets contain excessive information of lesser importance, directors are distracted from focusing on the most important issues. Certain core information should be presented in a manner that is concise and gives directors the information they need to supervise the bank in a professional manner.

4. Hold executive sessions at each meeting. Public companies are required to have executive sessions of the board without management. This best practice should be extended to private companies.

An executive session at each board meeting—even a brief one of only a few minutes—can serve as a tonic for the non-management board members, as well as for the bank executives. The executive session provides a forum for discussion of issues without management present and allows the independent members an opportunity to obtain the views of others without the influence of bank executives. Additionally bank executives will not feel panicked, because an executive session is taking place if it occurs at every board meeting.

5. Review audit committee composition. Public companies are required to have *all* independent board members on the audit committee, with a committee chairman who is considered a financial expert, such as a certified public accountant or someone who can understand financial statements. This best practice should be extended to private companies. While there are specific rules regarding how independence is established, generally audit committee members should not be bank officers or related to bank officers.

6. Review composition and size of the board. Many bank boards have been together for years, with no recent changes in composition. Some boards contain many members of one family, perhaps all related to the bank's CEO. Some boards consist of only five directors. A review of the composition and size of the board may be in order.

Public companies are required to have a majority of directors be independent. The definition of "independence" is complex, but generally it refers to a director who (1) is not an officer or employee of the bank, (2) is not related to bank employees, or (3) has not been employed by the bank within the past three years.

This best practice should be extended to private companies. The addition of board members to attain a majority of independent directors will add a new dimension to the decision-making process of the board.

A certain number of board committees are necessary for the proper supervision of the bank. Most banks have six or more committees, such as the loan, audit, asset/liability, trust, governance/nominating and compensation committees. Because of the number of committees that exist in most banks, small boards have difficulty adequately manning these committees, with directors carrying the burden of sitting on numerous committees. Expansion of these boards to nine or 11 members may be in order, so that the directors have the time to contribute in a meaningful way to the supervision of the bank.

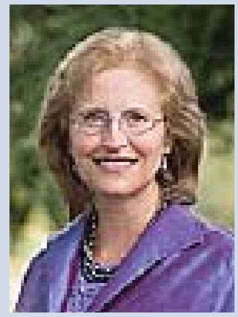
The collective expertise of a board should also be evaluated to determine whether additional expertise needs to be added. For example, does the board possess banking expertise? Although a requirement for newly chartered bank boards, this requirement is not imposed on existing banks, but perhaps should be. The board might also benefit from having a CPA or financial expert to serve as the audit committee chairman, as well as expertise that parallels the bank's loan portfolio or other activities.

7. Hold board member training. Many banks do not provide training to their board members. Training is important for all board members to assist them in fulfilling their duties and responsibilities and to give them a basis from which to make sound decisions. It is critical for new board members, especially for those unfamiliar with general corporate governance, much less the banking industry with all of its regulations and requirements.

New member board training should consist of an orientation session, as well as a training session geared specifically to new bank directors. Refresher courses for seasoned directors should be tailored to understanding the bank's business model, problems in the bank and changes in the regulatory environment.

These seven suggestions can improve the bank's corporate governance practices and help the board to make sound business decisions. The ultimate goal is to keep the bank off the front page of the morning's newspapers. ♦

About the Author



Catherine A. Ghiglieri is president of Ghiglieri & Company, Austin, Texas. A former Texas Banking Commissioner, she is co-founder of The Bank Directors' College. Ghiglieri has more than 25 years of bank regulatory experience, including 18 years with the Comptroller of the Currency. She earned a bachelor's degree from the University of Notre Dame and a JD from Georgia State University. The author can be reached at 512-329-5101, e-mail: cathy@ghiglieri.com.