



American
Bankers
Association

Update on Corporate Governance Issues


ABA Mutual Institutions Council

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Corporate Governance of Mutuals

ABA Publication Update



I. ABA Corporate Governance Update

- Comprehensive update to publication first produced in 2007
- Update 50 state analysis of state mutual charters
- Update discussion of federal charter under the OCC



I. ABA Corporate Governance Update

- Governance Differences - Federal vs. State Charters:
 - Federal:
 - Directors elected by members with proxy voting - one vote for \$100 deposit up to 1,000 votes
 - Nominating rights
 - Members with 10% of deposits can call special meeting
 - Right to inspect books and records
 - Right to amend bylaws
 - Right to communicate with other members



I. ABA Corporate Governance Update

– State:

- Many states are very similar to the federal structure depositor voting in proportion to deposits.
 - Some states have corporators
 - Some states have no “member” voting
- Not all states grant right to call special meeting, vote by proxy, amend bylaws.
- Most states do not permit member communication and right to inspect books and records.



Bylaw Changes Aimed At Preserving Mutuality



II. Bylaw Changes Aimed at Preserving Mutuality

- Recent trend indicates mutuals are revising corporate documents to make a mutual to stock conversion more difficult (thoughtful?).
- Three prevalent tactics:
 - Higher vote thresholds
 - Limit insider economic incentives
 - Articulation of “preconditions” to a conversion vote
- Most commonly done in other reorganization contexts. (no-stock MHC)



II. Bylaw Changes Aimed at Preserving Mutuality

- From [Boston Globe](#), April 27, 2011

“Salem Five Cents Savings Bank plans to disclose today that it has changed its bylaws to preserve its independence by making it much more difficult to change its ownership structure to a publicly traded company or other alternative.”

“The change will strengthen Salem Five’s standing as a mutually owned savings bank, and make it harder for future bank executives to take the company public, which in turn would potentially make the bank vulnerable to a takeover. A number of publicly traded Massachusetts banks, including DanversBank, have been gobbled up in the past few years.”



II. Bylaw Changes Aimed at Preserving Mutuality

“The new rules allow conversion to a stock-owned company only if there is a compelling reason. A bank merger would need to be approved by 80 percent of the trustees and corporators (who oversee the bank instead of shareholders), instead of the 50 percent threshold under the old rules.”

“Also, the new rules bar bank employees and overseers from personally profiting from a conversion by prohibiting them from receiving any stock in the company within five years of the change. And they can never profit from a conversion if the bylaws are changed or repealed.”



II. Bylaw Changes Aimed at Preserving Mutuality

- Bylaw sample...

“The board of directors recognizes the importance and value to its membership of the mutual form of ownership. The board remains committed to maintaining the institution as a mutual bank.”



II. Bylaw Changes Aimed at Preserving Mutuality

“The board of directors will consider a change in the institution’s organizational form only under circumstances that would materially and negatively impact the benefits accruing to the membership from its current organizational form, and only when another organizational form would provide greater benefits. It is anticipated that these circumstances would only arise from extraordinary events such as capital needs, a risk to the safety and soundness of the mutual industry, or a material change in business powers.”



II. Bylaw Changes Aimed at Preserving Mutuality

“In light of the benefits that accrue from the mutual form of ownership and consistent with current rules, no such conversion would be recommended by the board of directors, except after full, fair, and complete consideration and discussion of such matter based upon the advice of neutrally selected expert independent third parties who have no financial interest in the outcome.”



II. Bylaw Changes Aimed at Preserving Mutuality

“Upon any conversion, the board will take appropriate action to incorporate within the organizing documents specific provisions to ensure that directors and executive management are provided no financial advantages other than those provided to the general members of the institution.”



Nominating Committee Issues



III. The Nominating and Corporate Governance Committee

- Nominating/Governance is the next frontier in the evolution of regulatory enforcement and outside scrutiny :
 - It was Audit Committee (post Sarbanes-Oxley 2002)
 - Then, Compensation Committee (Dodd-Frank and Interagency Guidance 2009-2010)
 - Now, with emphasis on director qualifications, diversity, independence and succession, Nominating/Corporate Governance practices are increasingly in the spotlight



III. Roles and Responsibilities

A. Executive Succession Planning

- CEO succession begins with Nominating/ Governance Committee
- Regulators are expecting a “written plan” addressing planned succession and contingency
- Involves work with full board, executive officers and professionals (recruiters)
- Lack of succession plan is often a major deficiency, posing risk to institution’s continued independence, and prompting potential sale
- Should be periodically reviewed and updated (or affirmed)



III. Roles and Responsibilities

B. Recruiting

- Responsible for identifying and recommending new board members
- Need to conduct due diligence on candidates and vetting process should be documented
- “Renomination” should not be automatic and evaluation process should be documented
- Need to maintain appropriate balance of skills
 - Consider use of a matrix to map expertise, geographic representation, diversity, demographics, etc.



III. Roles and Responsibilities

C. Director Onboarding and Education

- New director orientation should be a robust in-house program
- Regulators have been very focused on evidence of Board education
 - External resources
 - Internal training (regular use of advisors)



III. Roles and Responsibilities

D. Governance Practices

- Awareness of current practices related to:
 - BOD and Committee composition; board minutes, independence, committee rotation
 - Corporate Governance Guidelines (borrowed from public companies)
 - They provide a framework for the company to be managed consistently pursuant to agreed-upon principles
 - They are principles that the board and its committees should adhere to when performing their responsibilities



III. Roles and Responsibilities

- For non-insiders, these guidelines are the best way to comprehend a company's corporate governance practices.
- Committee charter updates
- Annual Board performance assessments (attendance and contribution)
- External perspectives on governance effectiveness (ISS scoring system)



III. Governance Issues in Regulatory Exams

“Most weaknesses identified during the examination are of limited supervisory concern; however, the deficiencies related to corporate governance require a heightened level of attention by the board.”



III. Governance Issues in Regulatory Exams

“Management of the institution’s operations and general affairs is satisfactory overall; however, weaknesses in certain aspects of Board supervision warrant prompt attention.”



III. Governance Issues in Regulatory Exams

“Oversight provided by the Board of Directors is satisfactory in many respects; however, weaknesses identified with some past and present corporate governance matters are of concern as they expose the bank to reputation risk. The issues pertain to compensation levels for the top two executive officers, apparent conflicts of interest, and board independence.”



III. Governance Issues in Regulatory Exams

“Board members are reminded of their fiduciary duty to avoid potential conflicts of interest and even the appearance of self-serving practices. A critical personal characteristic for Directors is the capability of recognizing and avoiding potential conflicts of interest, or the appearance of same, which might impact their objectivity.”



III. Governance Issues in Regulatory Exams

“Acknowledge the shortcomings with past practices and provide appropriate training to all Directors to ensure a complete understanding of conflicts of interest and their fiduciary duties. Consider hiring a qualified, independent outside consultant for guidance.”



III. Governance Issues in Regulatory Exams

“Revise the bank’s ethics policy to address nepotism in hiring, promotion, etc., and preclude family members from being involved in all aspects of those processes.”



III. Governance Issues in Regulatory Exams

“Based on the acquiescence and/or facilitation of excessive compensation and conflicts of interest by the Board, the Board appears to give excessive deference to Chairman/CEO and appears to lack a healthy degree of independence, at least in these areas. The composition of the Board lacks diversity – 13 of 14 members are male and the average age of the outside members is 72. Four of 12 outside Board members are retired and three reside out of the area. Turnover on the Board has been limited; seven of the outside members have served for over 25 years; there have been only three new outside members since 1990.”



III. Governance Issues in Regulatory Exams

“To help ensure a proper degree of independence, the Board should take the following actions:

- Review regulatory guidance on fiduciary responsibilities and corporate governance matters, including best practices in banking and other industries. Consider hiring a qualified, independent, outside consultant for guidance.*
- Revise the N&G Committee Charter so that executive management is not responsible for appointing committee members. Furthermore, consider the appropriateness of even having the CEO and President/COO serve on the Nominating & Governance Committee – the committee that nominates Board of Director members and whose duty it is to supervise executive management.*
- Consider separating the roles of Chairman of the Board and Chief Executive Officer, by electing an independent Board member as Chairman.*
- Consider instituting a mandatory retirement age for Board members, as the bank’s by-laws require for Corporators.*
- Consider periodically rotating the members of the various committees, particularly the Board of Investment, to ensure active involvement of all Directors in all facets of bank activities.”*



III. Current Hot Topics

- Board size (and tenure)
- Age limits
- Classification/Declassification of the Board
- Combined or Independent role of CEO/ Chairman (Lead Director)
- Establish/Amend Nominee Qualification
- Majority Vote Threshold for Director Elections
- Term limits
- Nepotism
- Whistleblower protocol
- Enterprise risk management



IV. Concluding Thoughts