

THE ROLE OF THE BOARD OF DIRECTORS IN CHANGING TIMES

By [Stephen M. Klein](#)

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Evolution

Over the past three years during the financial crisis, the role of the Board of Directors has evolved to address changing times. In our frequent meetings with Boards of all sizes throughout the West, it is clear that there is some confusion on the appropriate role of directors in today's environment. A combination of economic, investor and regulatory pressures has reshaped that role. The purpose of this article is to provide some perspective and guidance to directors in these uncertain times.

The Basics

In layman's terms, directors have certain basic fiduciary duties to their company and its shareholders. These include the duties of care and loyalty. What this means is that directors need to exercise the judgment that an ordinary prudent person would use in similar circumstances. In English, directors need to make informed, thoughtful decisions. They need to get meaningful reports and information in advance of meetings, carefully review such materials, attend meetings and ask good questions. While the Board needs to trust management (or replace management if that trust is lost), directors still need to ask probing questions and test management's recommendations in a respectful, constructive manner. While directors' expectations have been raised in these challenging times, they must provide healthy oversight but rely on management to run day-to-day operations.

The Pressure From Regulators

With all due respect to the banking regulators, who have a difficult job in tough economic times, the Board should not take on the task of running the Bank on a day-to-day basis. With administrative actions very common, Boards no doubt will have enhanced involvement, more frequent and lengthier meetings and a greater commitment of time and effort. However, that oversight is not a substitute for Bank management. Given the regulatory scrutiny and exploration of mergers and recapitalizations, Boards must strike a fine balance between enhanced oversight and day-to-day management.

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“So-Called” Executive Sessions

As an outgrowth of Bank failures and economic stress and related pressures from regulators, there has evolved the more common practice of “Executive Sessions” of independent directors. The most recent roots of this practice come from the Sarbanes-Oxley Act for public companies. However, it appears there is confusion as to the purpose of these meetings. Many of our clients, both public and private, have simply adopted a practice of providing for executive sessions of outside directors on a monthly or quarterly basis. They are often just part of the regular agenda and the Board can exercise the right to have an “executive session” or not depending on need. This seems to work well since calling of such meetings on an ad hoc basis creates unnecessary suspicions by, and tensions with, management. Such executive sessions should have one purpose – to discuss the performance of the “inside directors,” i.e. the President and CEO. Following the session, the chairman should meet with any inside directors and summarize the Board’s discussions. Please remember inside directors have the same fiduciary duties as outside directors. All other discussions about the Bank should involve them. The purpose of such executive sessions is simple – to create a convenient forum to discuss the performance of the CEO/President without the CEO/President being present.

Finding a Balance

Ultimately, things will settle down to some semblance of normalcy and Boards can return to a more balanced role. However, the lessons learned over the past three years should not be lost. During the good times, we all tend to be a little less involved and focused. Going forward, Boards will have to raise the bar a bit and provide thoughtful, meaningful oversight, while avoiding micromanagement.

Takeaways

If anything, recent times have shown that many Boards were unprepared for the challenges their Banks faced. While the depth and breadth of the financial crisis were unforeseeable, we all should learn from the experience. Meaningful and continuous director education is a must. This can come from a variety of sources – trade association meetings, periodic updates by your CPAs, investment advisors, counsel, compensation consultants and independent loan reviewers. Last but not least, the Board should never be afraid of asking thoughtful questions in a respectful manner. All this assumes of course that directors are prepared for Board meetings and review their Board packets in advance. Our world has changed and we all must change with it, including directors.

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