

# ABA BANK DIRECTORS BRIEFING

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## THE DIRECTOR'S JOB

### 10 STEPS TO TURNING THE MOST BASIC BOARD TOOL—MEETINGS—INTO A BETTER INSTRUMENT

**B**ank director Don Musso's fellow board members had sent him a clear message: *We want you to attend more committee meetings.*

The message didn't come as an ultimatum nor as an angry resolution. It came as one of several findings of a board self-evaluation program. The members of the board that Musso was sitting on were queried about many things in the course of completing an annual questionnaire.

Not only did his fellow directors have Musso dead to rights—the busy consultant admits he had been missing too many committee gatherings because of conflicting obligations—but they were acting on his own recommendation. Musso is president of FinPro, Inc., Liberty Corner, N.J.. One of the things his bank consulting firm recommends that bank boards do is perform a board self-evaluation that looks at both the performance of the board as a whole, as well as the performance of the individual members.

Musso believes the self-evaluations are one of a number of steps that bank boards can take to improve the quality of meetings. These evaluations, frequently conducted anonymously, help identify weaknesses that can't help but play out during meetings.

#### IMPROVING YOUR MEETINGS

Musso and his associate Nicholas J. Ketcha, Jr., managing director of FinPro, recently discussed ways and means of improving board meetings with *ABA Bank Directors Briefing*. Musso is an entrepreneur with decades of experience in bank staff positions and in *de novo* banking, including board-level service. Ketcha, a relative newcomer to consulting,

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THE MONTHLY BULLETIN FOR AMERICA'S BANK DIRECTORS

## DEAR DIRECTOR:

### A World Of Challenges Faces Community Banks And Their Boards At Midyear Point

There is a great deal of noise in the legislative arenas of the nation's capital right now, and, yet, with the elections nearing, some old pros are predicting that in spite of lots of motion, little will actually wind up getting done before the clock stops on the current Congress.

Debates continue about financial data security legislation, regulatory relief, and more. Some proposals have a decent chance of becoming law, others less so, at least this time around. Important issues are brewing on the regulatory front, including the commercial real estate lending proposals we've told you much about, and the Wal-Mart controversy (see page 2).

But don't forget, banks do business not only in what one veteran called "Disneyland East," but also in the real world. Over the last few months we've been in half a dozen community banker meetings. Here's what we've been hearing:

**"Regulators worry more about how our bank studies for its tests, rather than how it scores"**

#### EXAMINATION TRENDS

Harder-nosed examinations have been reported by bankers so frequently that this trend is more than some isolated cases. Some say they are being told that their banks should upgrade their risk-management abilities, including increasing the number of employees assigned to risk management.

"The regulators seem to worry more about how our bank *studies* for its tests, rather than how we *score* on the tests," says one banker. This, actually, should be no surprise. Examiners, especially national bank examiners from the Comptroller's Office, have been following exam guidelines that

increasingly stress looking at the banks' systems, rather than focusing on lots of individual transactions.

Part of the tougher emphasis at least follows well-known concerns on the regulators' part. For instance, some bankers who are reporting tougher exams refer specifically to special targeted visits regarding commercial real estate portfolios. Speaking of one such examination, a midwestern banker dryly says of the exhaustive review: "I liken it to a colonoscopy."

Another banker, from the central states, has seen conflicting behavior. The banker says that older members of a recent examination team, having seen real estate crises in the 1990s,

approached the bank's commercial real estate concentration with perspective. However, the younger examiners, lacking experience but having recent training, tended to be more extreme in their judgments.

Lately, when the subject of examinations comes up, bankers from state-chartered institutions examined by FDIC seem to report the least-disagreeable experiences. The two points most bankers coming out of FDIC examinations seem to make is that those regulators have tended to be fairly cooperative and more interested in solving problems than finding fault.

By contrast, complaints heard here and there about national bank examinations are growing. A frequently expressed feeling is that national bank examiners are grading banks harder. The impact is such that the banks that previously earned "1" rat-

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BY THE EDITORS OF ABA BANKING JOURNAL

## DEAR DIRECTOR (CONT'D.):

ings, the top rank under the CAMELS rating system, receive "2"s even though nothing significant about the bank has changed. One national bank executive says he was told that, "You'll never be able to be a 1-rated bank," because his institution was too small to afford bells and whistles that the examiner considered necessary to earn the top rating.

**DEPOSIT INSURANCE REFORM**

In a recent issue we recapped new changes to deposit insurance coverage that were approved by Congress, with increased retirement account coverage the most notable immediate result.

What is bankers' reaction thus far?

We canvassed close to 100 community bank websites a few weeks ago and found only one or two institutions promoting new insurance levels at all.

In banker meetings where the subject has come up, the mood has been low-key. Bankers are pleased with the changes made, but aren't falling over themselves to get the word out. In part, the free-market's own response to the old insured-deposit limits—various mechanisms that enabled banks to significantly increase the effective coverage their customers could have, such as the ABA-endorsed "CDARs" program—seem to have stolen much of the thunder. The free-market's products can still protect much more than can the present and future increases in FDIC levels.

"It will be nice to have this for some of our older customers, our retired folks," says a Texas banker. "But for most, it's almost a nonevent at this point."

*However, it's important to remember that the revised insurance assessment system imposed by the legislation will ease what might have been. The legislation will make insurance premiums lower for most banks than they would have been under previous rules.*

*"Banks would have been paying more premiums, sooner," says a longtime legislative hand.*

**DEPOSIT-GATHERING TRENDS**

Interestingly, bankers seem to be falling into two categories: those who have at least a decent amount of local deposits but sparse lending opportunities, or those who have strong loan demand but difficulty raising deposits.

Bankers who struggle to raise deposits say CD customers have been growing increasingly sophisticated.

"The percentage of our CD renewals and customers with new CDs who ignore our published rates and instead come in to negotiate a rate is rising," says a central states banker. Some see this as a product of the Internet.

Some strategies that worked well for deposit-hungry banks have become so commonplace that they are necessary just to maintain the status quo.

"Everybody offers free checking now," comments one CEO, so this

does nothing special in many markets.

**HEALTH SAVINGS ACCOUNTS**

Some community banks have devoted significant resources to promoting these accounts, which dovetail with special high-deductible medical insurance policies. Other banks have only dipped their toes into the water.

It's early to say for sure, but conversations with these pioneers indicates that casual efforts aren't worthwhile. You've got to jump in with both feet. And banks just considering these accounts need to know that it will take time to build them up to significant levels.

*One bright spot:* Bankers find these accounts have a particularly strong pull for higher-earning customers and for professionals, such as lawyers and doctors.

**AUDIT COSTS**

In many cases, both banks that have had to get involved in the Sarbanes-Oxley Act's requirements and those that are not covered by it report that audit expenses are up. This is even where a banking company was an "accelerated filer" and already went through one round of SOX.

The cause, for the non-SOX banks, seems to be an attitude on the part of accounting firms and field regulators that SOX requirements are "best practices" that all should adopt. As for banks covered by SOX, one CFO

**Wal-Mart's "bank" proposal stirs controversy in D.C.**

FDIC has completed hearings on Wal-Mart's controversial application for deposit insurance for a proposed "industrial bank" in Utah. Action on the application isn't expected until FDIC has an appointed chairman. Sheila Bair, who served in the first term of the Bush Administration in a bank-related Treasury Department post, has been nominated, subject to hearings and Senate confirmation.

Wal-Mart has tried several means of getting into banking in some fashion, over the years. It already participates in financial services in several ways. While it insists its limited-service industrial bank wouldn't turn into Wal-Mart bank branches in every store, many don't believe the retailing giant.

Could Congress step into the midst of this pending situation? Veterans don't see that happening at this stage. One says that Congress is highly unlikely to act until and unless it has to, and until FDIC makes a decision, that "has to" isn't really there. However, if Utah and FDIC approve the proposed charter and the

insurer, then it is expected that Congress will act very quickly.

Some have asked if FDIC might try to reach a compromise in its decision on the Wal-Mart application by explicitly barring Wal-Mart from going further than the payments functions it claims it wants to do, such that the deposit insurance would be void if the company did step out of bounds. Experts doubt the agency will do that, and, even if it did decide to try this gambit, they aren't sure that the agency would be on sound legal grounds.

If Congress does act in this situation, it could open up the entire matter of the longstanding effort of U.S. law to separate banking and commerce. For instance, some fear that Wal-Mart-related legislation could give the National Association of Realtors additional leverage to quash banks' hopes for real estate brokerage power. (See "Filing Cabinet" at [www.bdbonline.biz](http://www.bdbonline.biz) for ABA's testimony at the Wal-Mart hearings.)

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remarks that even as various SOX costs get "baked into the pie," over time, there has been a tendency for red tape to grow and become more expensive.

**HURRICANES AND AVIAN FLU**

Even as banks and communities hurt by last year's major hurricanes continue to recover, the new hurricane season approaches with predictions that the northern Atlantic states are overdue for big blows. Some insurance companies have been backing out of certain markets.

Even as banks begin revisiting their business continuity plans with a "weather eye"—bankers who lived through Katrina, Rita, and Wilma say you *can't* plan too much—regulators and compliance specialists are urging banks to also give some thought to the impact on daily operations of a major outbreak of the much-discussed avian flu.

One disaster recovery expert says it is not unreasonable for a bank to be considering how it could handle business if 25% of staff were stricken. And, he adds, those could all be key players.

*Some bankers worry that such talk will lead to another Year 2000 scare; more than one CEO believes that computer threat was overblown alarmism.*

**FACES OF FRAUD**

Community banks are seeing fraud, too.

- Regulators frequently publish warnings of counterfeit checks that frauds try to cash, drawn on banks large and small.
- Meanwhile, Americans' use of plastic payment cards has been rising, displacing more checks. And as this goes on, a rising problem is debit card fraud. In one recent community bank meeting, nearly every hand went up when a speaker asked if any of his listeners' banks has suffered some form of debit card fraud in the previous year.
- Various forms of mortgage fraud are also showing up, not only among large, volume-oriented mortgage lenders but also among community banks.

Sincerely

  
For ABA Banking Journal

spent most of his career at FDIC, finishing with a four-year stint as FDIC Director of Supervision. Prior to joining FinPro, Ketcha served as director of the New Jersey Division of Banking. Both consultants have sat in countless board gatherings and pretty much seen it all.

One hopeful note: They are seeing better boardroom performance. "It's a lot better than it was five years ago, and much, much better than it was ten years ago," says Musso. They feel that the Sarbanes-Oxley Act served as a heavy reminder to boards about the basics.

"Ten years ago," continues Musso, "you frequently would see the CEO run the meeting, and it was fairly predictable that everyone would rubber stamp the things the CEO brought up. That's the minority these days. Directors are more and more engaged now."

Steps Musso and Ketcha recommend:

**(1) Schedule board meetings a year in advance.** Musso says too many boards set the date of the next meeting at the conclusion of the present one. This leads to much wasted time, with members comparing calendars, debating one day versus another, and more. Musso says if the board sets the meetings a year ahead, "then people will schedule their affairs around those dates."

Musso says this advice also includes committee meetings, which, ideally, should be held immediately before or after meetings of the full board.

**(2) Insist on attendance—physical as much as possible.** Musso says more and more banks that he works with build director attendance policies into board charters and related documents. While 100% perfect attendance at board and committee meetings isn't expected, boards are growing harder-nosed about no-shows, as well as "dial-ins." They are beginning to stress that directors are expected to perform, not only at formal occasions like board meetings, but also in efforts to promote the bank with clients and in the community. To do that, a director must be around, and in town.

Indeed, the "dial-in" director is being aimed at, says Musso. Many banks, especially those in northern climates, have some of these. They are directors who call in from Florida or someplace else warm. Their place at the board table consists of a disembodied voice in a "squawk box," something like the old

**Phone seminar covers Audit Committees**

The next topic in the ABA/ABA Bank Directors Briefing phone seminar series is "Directors and the Audit Committee: Directors in the Spotlight," June 21, 2-3:30 PM ET.

Confirmed speakers include Robert Storch, FDIC's Chief Accountant; Philip Smith of Gerrish, McCreary & Smith, Memphis; Kathleen Blanchard, consultant, Enterprise Consulting and former first SVP, Yardville National Bank; and Sally Miller of ABA Government Relations.

To register, call 800-775-7654 and ask for event 11198.

"Charlie's Angels" show. The occasional call-in is OK, says Musso—some CEOs may even have to do it to make their schedules work—"but not six out of twelve meetings."

But what's so wrong with this, when we live in an age of e-mail, camera phones, and more?

Musso says it's a matter of focus, not just presence. He's been to meetings with "dial-ins" on many occasions, and he doesn't think call-in board members can give their full attention to proceedings. (Some call from lunch, and Musso can hear utensils clinking and other diners talking.) There are documents to be looked at that might not be clear to the director without having a staff member point to significant items, for instance. Some documents might not even be ready until just before distribution.

**(3) Reconsider the "holy book of board matters."** Some banks send out their board packages with plenty of advance time for reading proposed policies, reports, and financial statements. Some are even doing this, now, with secure electronic delivery. But some banks still insist that directors' materials not leave the bank's premises, and only make them available during the meeting. They materialize just before the gathering. Staff whisks them away afterwards.

"There's no way you can expect a director to read and absorb a board package on the spot," says Musso. Financial statements, policy drafts awaiting board approval, and more, require

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more and more sheer reading time, let alone understanding time. He and Ketcha think overly restrictive control on binders and the like is a pretty good sign that management is doing too much of the director's job.

Yet confidentiality is important. What Musso sees as a far better alternative for archival board materials—things you'd naturally not want wandering around the community—is a five-drawer filing cabinet kept in the boardroom; only board members receive the keys that open it. This "director resource center" would provide board members with access to most of what they need to refer to in order to prep for meetings or to refresh themselves on ongoing situations. This would include everything from past board packages to the minutes books.

**(4) Give directors plenty of time to review board packages.** Directors should have enough time to go through the package materials such that they have a chance to ask for clarifications and improvements to key documents, such as proposals, in advance of the actual board meeting. Indeed, Musso argues that board members should insist that proposals that don't make sense be fixed or rejected.

**(5) Change your board's approach to agendas.** Most board agendas follow a set formula, which places many routine items first. The problem with that, say Musso and Ketcha, is that boards can get bogged down in a lot of old news. When that happens, priority items that should be addressed on a timely basis get postponed. Alternatively, the meeting drags on.

The consultants recommend stacking the board's agenda by priority order. All the #1 top priorities would be scheduled first; the 2s second; and the 3s last. In this way, the most important matters get the better part of the meeting time. Further, Musso says old items should be subject to a time limit.

**(6) Don't bypass the committee system.** In addressing specialized issues, it's important not to negate the work of the board's various committees. Musso suggests that if the board starts finding it necessary to meet more often than monthly, in most cases that means the committees are not functioning properly.

"In these cases," says Musso, "the full board is acting as the committee in every case. The board has forgotten the importance of delegation of duties and division of labor."

Ideally, committee membership is based on differing types of expertise on the board, with directors with appropriate strengths going to appropriate committees. Bypassing the committee system, then, works against have well-backgrounded directors tackling key issues in detail.

**(7) Spread out the complicated stuff.** Some banks present all policies to the board for review and approval at one meeting annually. Who's kidding whom, asks ex-regulator Ketcha? You can't do it all at once, and be doing it right. It makes more sense to distribute this task over multiple meetings.

**(8) Follow Robert's Rules of Order, but don't use them.** This sounds contradictory, until you understand the intent. Most

parts of most board meetings don't require the use of these procedures. But Musso and Ketcha regard these classical rules for running meetings as a sort of fire extinguisher for board gatherings that are burning out of control. If a board is officially governed by Robert's rules, then the meeting that has derailed can be fixed by having the chairman invoke the rules to rein things in.

**(9) Don't go overboard with "executive sessions."** An executive session is a special board meeting, or portion of a regular meeting, where the board asks members of management to absent themselves. In this way, the outside directors can discuss an issue or issues among themselves. Such gatherings are generally led by the chairman, if he or she is an outside director, or by a designated outside director, sometimes called the "lead director," if this is a standing assignment.

Executive sessions have caught on even before passage of the Sarbanes-Oxley Act as a much-promoted means of encouraging independent thought on boards. But Musso and Ketcha cau-

tion that a little goes a long way with this approach. When overdone, executive sessions have a way of encouraging an "us versus them" mood. Musso believes executives should be given a recap of what the executive session discussed, which, while avoiding specifics, lets the managers know where the board is coming from. (Of course, some matters must remain confidential.)

But sometimes executive sessions backfire. As an illustration of the harm that an overdose of executive sessions can do, Musso tells the story of a client bank's board whose CEO was clearly not performing adequately. The board's job, in time, was to bring its unhappiness to the executive's attention, and move from there to some resolution. Instead, the dissatisfied directors would move into executive session nearly every month. There they'd complain among themselves about the CEO's poor record, but they'd never say a word to the banker. The executive session became a lightning rod that deflected the board's energy away from the person they should have been communicating with in the first place.

After consulting with Musso and Ketcha's firm, the board was told to take the matter in hand, skip the executive sessions, and tell the CEO what the score really was. In the end, the CEO and the bank parted company, and the bank was on track.

**(10) Strike a balance with the minutes.** A good meeting ought to be reflected in its minutes, but there are better ways of doing so than others.

Some boards go so far as to have meetings taped or taken down by steno typist. "That's a bit of overkill," says Musso. (Watch [www.bdbonline.biz](http://www.bdbonline.biz) for a new special section on minutes at the end of May.) So, literal transcripts are out for Musso and Ketcha. However, the team opposes overly abbreviated minutes too. Ex-regulator Nick Ketcha believes that if a board must err, it should be on the side of more detail: "You get into more trouble with an abbreviated set of minutes than a detailed set. That is, unless you are doing dumb things."

**"You get into more trouble with an abbreviated set of minutes than a detailed set"**

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