

2007 Directors Conference


CONCURRENT SESSION **Board Evaluation**

John Oliver, Laurel Management Systems, Inc.

Friday, November 9, 2007
9:15-10:15 am



WIB/AABD Annual Directors Conference Board Evaluation



Laurel Management Systems, Inc.

Palm Springs, California. ©2007

Contact: oliver@globalbanktraining.com

Board Evaluation

- From the perspective of someone who works with boards on corporate governance and strategic planning issues
- BUT does not offer board evaluation as a service
- Independent observer of The Good, The Bad and the EXTREMELY UGLY

Board Evaluation

- Board Evaluation is simply seen as a “best practice” by the most diligent boards. The logic....

The Board should want the banks performance to be constantly improving



To achieve that, management and employee performance must be constantly improving



The Board must also focus on continuous improvement

Board Evaluation

- Look at the ENVIRONMENT that we operate in:
 - Intense Scrutiny
 - Regulators
 - Stockholders
 - Depositor
 - Consumer Groups
 - Dramatic Change
 - Disintermediation
 - Fierce Competition
 - Commoditization

Board Evaluation

- Look at the ENVIRONMENT that we operate in:
 - An industry where director responsibilities are far more onerous than others
 - Protect the interest of stockholders (like all other directors)
 - PLUS
 - Protecting Depositor Funds (a major “public interest” responsibility)
- Isn't it simply prudent to undertake Board Evaluations with a goal of continuous improvement?

Board Evaluation

- We operate in a culture that emphasizes COMPLIANCE
- Any business model that is compliance-driven will never be optimally successful.

A system of governance that is compliance-oriented will never get you close to truly effective governance. Best practices means a commitment to excellence in governance, not just following the rules

Board Evaluation

1. See the Need For It
2. Act on That Need (Professionally)
3. Follow Through

The Good	See the Need, Do it Well and Follow Through	5%	Positive Organizational Impact
The Bad	Do it Poorly (enough for compliance) or Don't Do it at All	70%	Little Organizational Impact
The Ugly	See the Need, Do it Well BUT DON'T Follow Through	25%	Negative Organizational Impact

Board Evaluation

1. See the Need For It
 - There is a direct correlation between boards that perform at consistently high levels and companies that produce superior results
 - The best boards constantly look for ways to improve their effectiveness
 - Improving anything will only be optimally successful with relevant and honest feedback

Board Evaluation

1. See the Need For It

- The Common Law DUTY OF CARE Measures the **QUALITY** of the job you do (individually and collectively)
- How many jobs are there in life where your performance is not judged by someone?

"The unexamined life may not be worth living."
Socrates

Board Evaluation

1. See the Need For It

- Far fewer community banks undertake board evaluations than other types of company. WHY?
- The majority of banks have no written job description for directors (a priority that governance committees should address)
- If you don't know what's expected of you how can you be measured?

"How can they evaluate me if I have never been told what the expectations are?"

Board Evaluation

1. See the Need For It

- Some boards only do it because it is required by regulators (Compliance Driven)
- “We do it because we are told we should, but we only put enough effort into it to keep the regulators happy.”
- Good governance includes striving to endlessly improve performance so try to see it as a powerful tool to enhance effectiveness

Board Evaluation

1. See the Need For It

Establish a common understanding of why this is a worthwhile course of action FOR THE BANK and therefore for its shareholders.

Board Evaluation

2. Act on That Need – (Professionally and Effectively)

First Things First – Decide Which of the TWO Components to Undertake:

- **Board Effectiveness Evaluation**
 - The collective workings of the group (including committees)
 - The BOARDS contribution to the performance of the bank
- **Director Effectiveness Evaluation**
 - The performance of each individual director

Board Evaluation

2. Act on That Need – Professionally and Effectively

Put into place the infrastructure that will allow the process to work:

Develop Written Policy that Establishes:

- The parameters of the process
- The methodology
- Formalizing what questions will be asked (customize consultants off-the-shelf questionnaires)
- Responsibilities (committees, consultants, etc.)
- How the evaluations will be reviewed
- Specific actions that will be taken based on the findings (DO NOT leave this until after the evaluation is completed.)

Board Evaluation

2. Act on That Need – Professionally and Effectively

- Two Components:
 - **Board Evaluation** and **Director Evaluation**
- Let's first address BOARD EVALUATION (because it is the least intimidating of the two!)
 - Each individual director should get a questionnaire to evaluate the board as a whole and the committees of the board
 - Should address the collective skills of the groups in question

Board Evaluation

2. Act on That Need – Professionally and Effectively

- **BOARD EVALUATION**
 - Question topics should include:
 - Understanding of Responsibilities
 - Independence
 - Composition and Structure of the Board
 - Composition and Structure of Committees
 - Strategic Planning
 - Policy Development
 - Board Succession
 - Bank Succession Planning
 - Oversight

Board Evaluation

2. Act on That Need – Professionally and Effectively

■ **BOARD EVALUATION**

- Question topics should include:
 - Financial Acumen
 - Business Development
 - Conflicts of Interest and Ethics
 - Meetings
 - Communication
 - Understanding and Oversight of Risk
 - Decision-Making
 - Board/Management Relationship
 - Information Dissemination

Board Evaluation

2. Act on That Need – Professionally and Effectively

■ **BOARD EVALUATION**

- Question topics should include:
 - Questioning
 - Level of Participation
 - System of Checks and Balances for Management Decisions
 - “The effectiveness of our board could be improved by:
_____”

Board Evaluation

2. Act on That Need – Professionally and Effectively

- **BOARD EVALUATION**

- It can be very useful for each individual director to his/her own SWOT analysis of the board
 - Strengths: major, currently existing, **positive factors** or advantages that impact the effectiveness of our board and could affect its future.
 - Weaknesses: major, currently existing, **negative factors** or disadvantages that impact the effectiveness of our board, and could affect its future.
 - Opportunities: major factors which either currently exist or you project will occur in the future, which could be used to the advantage of the board, thereby improving its overall effectiveness.
 - Threats: major factors which either currently exist or you project will occur in the future which could be detrimental to the effectiveness of the board unless they are actively avoided, minimized or managed.

Board Evaluation

2. Act on That Need – Professionally and Effectively

- **BOARD EVALUATION**

- Get a customized report with feedback and suggested action plans from your consultant

Board Evaluation

2. Act on That Need – Professionally and Effectively

■ **DIRECTOR EVALUATION (the tough one)**

- Every institution needs to understand its STRENGTHS and WEAKNESSES.
- We evaluate the S & W of the bank as part of the strategic planning process
- We evaluate the S & W of the management and employees as part of their annual performance review.

- Now best practices is for the S & W of the directors to be evaluated, with the goal of constantly improving governance

Board Evaluation

2. Act on That Need – Professionally and Effectively

■ **DIRECTOR EVALUATION (the tough one)**

- Strongly recommend an outside facilitator
 - Takes the politics out of the process
 - Adds more objectivity
 - Directors are more willing to be open and candid
- If it is anticipated that the process will be controversial warn the consultant ahead of time
- If the process is in response to a regulatory demand (MOU, C&D, etc.) you **MUST** use an outside facilitator. Regulators call this a “management study” and there has been some resurgence in them over the last few years.

Board Evaluation

2. Act on That Need – Professionally and Effectively

- **DIRECTOR EVALUATION (the tough one)**
 - Because of the delicate nature of this process your consultant **MUST** be highly experienced in this field.
 - Each individual director completes a **SELF-EVALUATION** and a separate evaluations of each of the other board members.
 - Award score in multiple areas
 - Process can be online or paper based

Board Evaluation

2. Act on That Need – Professionally and Effectively

- **DIRECTOR EVALUATION (the tough one)**
 - Questionnaire topics should include:
 - Understanding of the role and responsibilities
 - Levels of knowledge
 - Industry
 - Bank
 - Participation
 - Attendance
 - Willingness to question
 - Independence of thought and action
 - Conflicts
 - Business Development
 - Continuing education

Board Evaluation

2. Act on That Need – Professionally and Effectively

- **DIRECTOR EVALUATION**

- Each director receives a report showing both a SELF SCORE and an AVERAGE SCORE FROM PEERS
- The report must be CONFIDENTIAL (Directors DO NOT get to see each others reports)
- Major gaps between Self Score and Peer Scores should be addressed immediately by the individual

Board Evaluation

2. Act on That Need – Professionally and Effectively

- **DIRECTOR EVALUATION**

- Get a customized report with feedback and suggested action plans from your consultant

Board Evaluation

3. Follow Through

- Possibly the toughest part of the entire process
- For **BOARD EVALUATION** the report should be provided to and discussed with either the Governance Committee or the entire board (as decided when the parameters were originally agreed)
- Governance Committee should immediately assign action items and timelines to resolve issues and improve performance
- Progress reports should be made at every board meeting
- **DON'T DROP THE BALL**

Board Evaluation

3. Follow Through

- For **DIRECTOR EVALUATION** there is a much heavier reliance on individuals taking action
- Directors receiving evaluations that indicate certain shortfalls in their skills, knowledge or performance are expected to act in a prudent, diligent manner to address those issues.
- Ask the question "How can I improve in this area?"
- Remember the **DUTY OF CARE** under which the common law claim of negligence is most often seen.
- Board Chairmen sometimes act as mentors in this situation.

Board Evaluation

3. Follow Through

- Requires a huge commitment to your bank
- Requires a willingness to act on constructive criticism
- Requires codifying at the start of the process

Board Evaluation

1. **See the Need For It** – If your board doesn't genuinely see a need for it and the potential benefits
DON'T DO IT
2. **Undertake it Professionally** – If your board is not prepared for the challenges of doing it well
DON'T DO IT

Board Evaluation

3. **Follow Through** – If your board is not prepared to act on the findings
DON'T DO IT

4. **P.S.** If you are thinking of doing this internally without the unbiased help of an disinterested third party
DON'T DO IT


Board Evaluation

"We'll be fighting the wrong war if we simply tighten procedural rules for boards and ignore their more pressing need – to be strong, high-functioning work groups whose members trust and challenge one another and engage directly with senior managers on critical issues" *Jeffery Sonnenfeld*

Don't look at Board Evaluations as just another procedural necessity. See them as an enhancement to the performance of the bank and to shareholder value



Board Evaluation



Laurel Management Systems, Inc.

Palm Springs, California. ©2007

Contact: oliver@globalbanktraining.com