Bank Board Selection and Nomination Process – Think Outside the Box

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Although at many financial institutions, the Board nomination process follows a simple scenario each year (i.e., renominate and elect the current Board), this seemingly simple process may not always be in the best interests of the institution. In some cases, institutions should add outside directors to their Boards. In other cases, Board members with special skills will need to be recruited.

As proxy season approaches, bank Boards of Directors will decide who to nominate as directors at their upcoming shareholder meetings. For many banks, the incumbents will be renominated, unless they are retiring or not standing for reelection on their own volition, and they will almost certainly be reelected by shareholders. Is there more to it than that?

The Board selection and retention process can be one of the keys to successful bank performance. The composition of the Board should reflect the business strategies adopted by the bank. Incumbency can be an important ingredient in having an experienced and cohesive Board, but it does not always serve the changing strategic focus of the bank or the need for the Board to have special expertise on the Board. Here are some issues which your board may wish to consider as part of the nomination process.

How are Board Members Selected?

Banks can select persons to serve on their Boards through the efforts of the Board or a nominating committee. Professional search firms sometimes assist banks in identifying director candidates. AABD also helps find the right director for its member boards.

Should a bank have a nominating committee and, if so, should the nominating committee consist solely or predominately of outside directors? Companies whose stock trades on the NYSE or Nasdaq must have a nomination committee that consists solely of independent directors. Banks and bank holding companies whose stock is not so traded are not required to have nomination committees.

If having a nomination committee permits a more effective and focused approach to the selection of board members, then AABD's advice is to have one.

What are the Skills of the Nominee?

Board members must fulfill certain minimum fiduciary obligations. For bank board members, the board member should have or acquire some knowledge of the banking industry, bank financial statements, banking trends, bank regulation and examination.

A reading of suits by the FDIC filed during and after the Great Recession against former directors of failed banks suggests that board members may need more skills and training than previously understood. These suits raise the bar for bank directors, many of whom are ill-equipped to meet the elevated standards that the FDIC seems to be expecting.

Therefore, it is important for the board of directors to evaluate prospective Board members (and incumbents) as to their basic understanding of their duties and the responsibilities, their knowledge of basic banking industry issues, their understanding of how to underwrite loans and investments and the asset-liability principles applicable to banks. Knowledge of banking for directors has historically not required specialized knowledge, and for those candidates who are otherwise qualified, lack of banking knowledge initially (even the heightened knowledge that might be needed now) can be remedied through an orientation program and further training designed to provide the new director with the basic skills.

AABD provides specialized bank director training at the bank's location, including a core course that can lead to discounts and/or better coverage under the bank's D&O policy. It also sends the right message to bank examiners that the board members are taking their responsibilities seriously.

As banks expand into non-banking activities, having a director with experience in those activities would be advantageous. The bank's strategic plan will help pinpoint the resources needed to meet the bank's strategic direction, including director resources.

With the increasing regulatory demands place on bank directors, it is advantageous to have board members who have strong backgrounds in audit, executive compensation, and risk management.

Incumbency

Experience as a bank director is valuable to the institution. However, incumbency should not be the sole criterion in deciding whether the person should be re-nominated. There are a variety of reasons why incumbents should not be re-nominated or reelected. It is sometimes difficult to make changes. The board evaluation process that AABD encourages, if properly and candidly conducted, will produce answers on whether an incumbent should be re-nominated.

Business Development

AABD's surveys of bank directors indicate that many community banks expect or require their directors to generate business. Particularly for community banks that may not have significant marketing and advertising budgets, directors can play an important role in generating business. The perceived ability of an individual to attract business for a bank is often an important consideration for membership on the board but should not be the only criterion.

Banks may wish to consider using a tracking system which records how successful individual bank directors are in generating business and can consider the individual director's production in determining whether the director will be re-nominated. Some board members who are otherwise contributing to the Bank through expertise and judgment should not be judged solely on the amount of business they generate.

Diversity

It is common for Boards of Directors to nominate persons who they know or do business or socialize with. Often, these are people who have similar backgrounds and are of similar age to those who already serve on the Board.

But a Board of Directors consisting of persons who are of similar age and background will not represent the diversity in a particular community. Attracting persons who are different ages and have different backgrounds, memberships, associations and other relationships to serve on the Board should enable the bank to reach out to a wider variety of people and businesses in the community. Women and minorities often are underrepresented on bank boards.

Nominating or appointing a person because of their race, color, creed, ethnicity, or gender discriminates against those who are not members of the favored race, etc.

AABD recognizes the pressure on bank boards from various sources to nominate persons based on those historically prohibited bases. In light of these developments, it is appropriate to consult with your counsel for advice.

Geography

Most community bank boards consist almost entirely of persons who reside or work in the markets served by the bank. This is part of the strength of a community bank, but there may be occasions where the skill set or background that the board may need is not readily available locally. Boards should be open-minded in seeking candidates from outside the community who can fill a need at the board level that might not be available locally.

Personal Qualities

A bank's reputation is reflected by the reputation and character of its directors, officers, and employees. Personal integrity and honesty are essential to service on a bank Board of Directors.

Time and Motivation

A director who does not have enough time to devote to his or her duties to the bank will not be a capable director, regardless of the person's other qualifications. AABD surveys reflect that directors spend, on average, almost 40 days a year on bank director responsibilities. Being a bank director represents a major commitment of time and energy. Persons who have too many other responsibilities or who do not have a strong desire to be a bank director should not serve and should not be nominated.

Conflicts of Interest

The Board's evaluation of a prospective Board member should also entail the actual or potential conflicts that service on the Board may create for the Board member and the bank. In some instances, the conflicts will disqualify the individual; other conflicts would not bar a person from serving on the Board but require that person to not participate on any matter in which the person may have a conflict (e.g., an attorney whose client has applied for a loan).

Stock Ownership

AABD believes that significant ownership of bank stock can be an important ingredient in motivating a person to be a productive director. This does not mean that the person needs to be wealthy or own a large quantity of stock. Ownership of a relatively small amount of stock representing a significant percentage of a person's assets can also motivate that person. Stock ownership helps to align the interests of a bank director with those of the bank's shareholders, which encourages the director to be motivated by the "bottom line" and the long-term success of the bank.

Conclusion

The process of nominating directors should not be as simple as automatically renominating the incumbent Board. Boards should evaluate their Board membership as part of their strategic plan and make changes or make additions consistent with that plan.