

# **Western Independent Bankers Association**

## **Annual Conference**

**Kauai, Hawaii**

## **Directors Program**

***“When Things Go Wrong”***

**March 2005**

**Welcome!**

**Today's Director's Program Will Address**

**Appropriate Board Action**

**"When Something Goes Wrong"**

**Doing the "*Right Thing*" is Not an Easy Job!**

## **Today's Program is a "Discussion" – Not a Speech**

### **Review The List of Potential Topics**

- ✓ **Please Mark the Topics You Want to Discuss**  
A WIB Staff Member Will Pick Up & Prioritize

**Our Goal Today Is To Select Several Issues**

**That Are Most Important To You**

**Please Participate!**

## Potential Discussion Topics

- ✓ **Conflict of Interest: Bad Loan to a Board Member**
- ✓ **CEO Performance: Missed Performance Targets - Again!**
- ✓ **Strategic "Crossroads": Unexpected Merger Proposal**
- ✓ **Governance Issue: Remove/Replace a Board Member**
- ✓ **"Tone at the Top": Suspected "Personal Relationship"**
- ✓ **Financial Reporting: "Restatement" Required**
- ✓ **Internal Control: Suspected Internal Fraud**
- ✓ **Regulatory Problem: "Failed" Exam & MOU/C&D**

## Discussion Moderator

**Charles J Thayer**

Chairman

Chartwell Capital Ltd.

- **Management Experience**

- CFO \$5 Billion Asset Bank - NASDAQ
- EVP \$40 Billion Asset Bank - NYSE
- CEO Consumer Products Company - NYSE

- **Board Experience**

- \$2 Billion Asset Florida Bank - NASDAQ
- Independent Power Company – NASDAQ
- Consumer Products Company – NYSE
- National Medical Research Non-Profit

- **Board Advisor**

- Banking Clients – Nationwide
- Advisory Board – American Association of Bank Directors

# Conflict of Interest

## Bank Board Member May Default on a Large Loan

- **Get the Facts**
  - Who Investigates? Full Board/Audit Committee/Special Committee?
  - How? Internal Investigation/Independent Counsel?
  - Credit Evaluation? Internal/External Experts?
  
- **Risk Assessment**
  - Likelihood of Default/Nature of Credit Problem?
  - Financial Risk? To the Bank? To the Board Member?
  - Legal Liability? To the Bank/To the Board?
  - Regulatory Liability? Regulation O?
  - Reputational Risk? Impact of Adverse Publicity?
  
- **Action**
  - Disclosure? Internal/External?
  - Request Resignation? What if "No"?

# CEO Performance

## Missed Performance Objectives - Again!

### CEO Selection – Your Board’s Most Important Function

- **Get the Facts**

- Who Evaluates? Compensation Committee/Full Board?
- Expectations? Benchmarks? “Peer” Performance is a “C”
- Identify the Issue: Performance vs. Personality?
- How? Internal Investigation/Independent Counsel?
- Confidential Contact with Other Bank Officers?
- Expert Evaluation? Compensation/HR Consultant?

- **Risk Assessment**

- Legal Liability? Employment Law/Contract?
- Financial Risk? Severance/Litigation?
- Market Value? Will New CEO Likely Improve Bank’s Value?

- **Action**

- Resignation? Cost & Disclosure
- Termination? Cost & Disclosure?
- Interim Management/Executive Search?

## Strategic Crossroads

### Your Bank Has Received an Unexpected Merger Proposal

- **Get the Facts**
  - Who Initiated Proposal? Unsolicited/'Solicited'?
  - Who Evaluates? Full Board/Special Committee?
  - How? Independent Counsel/Investment Banker?
  - Evaluation Benchmark? Highest Shareholder Value?
  
- **Risk Assessment**
  - Legal Liability? Management/Board Members?
  - Shareholder Reaction/Litigation?
  - Financial/Market Risk?
  
- **Action – Timing & Disclosure**
  - Ignore Merger Proposal?
  - Reject Merger Proposal?
  - Accept Merger Proposal?

# Governance Problem

## Need to Remove/Replace a Board Member

- **Get the Facts**
  - Why? Personality/Performance?
  - Who Evaluates? Nominating Committee/Full Board?
  - How? Self Assessment/Independent Expert?
  - Investigation/Independent Counsel?
  
- **Risk Assessment**
  - Legal Liability? Director/Shareholder Reaction?
  - Financial Risk? Litigation/Proxy Fight?
  - Reputational Risk? Adverse Publicity?
  
- **Action**
  - Resignation? Cost/Disclosure?
  - Nomination? Not a Candidate in Your Next Proxy?

## **“Tone at the Top”**

### **You Receive Information that a Senior Executive has a “Personal Relationship” with a Staff Member**

- **Get the Facts**
  - A Very Sensitive Issue – Your Board May be the “Last to Know”
  - Source of Information? Employee/Customer/Spouse/“Hot Line”?
  - Who Investigates? Compensation Committee/Full Board?
  - Confidential Contact with Other Bank Officers?
  - How? Internal Investigation/Independent Counsel?
  
- **Risk Assessment**
  - Legal Liability? What If Information is False/Accurate?
  - Exposure to Employment/Sexual Harassment Litigation?
  - Reputational Risk? Adverse Publicity?
  
- **Action**
  - Reprimand/Resignation/Termination?
  - Cost/Release? Disclosure?

# Financial Reporting

## Restatement Required by SEC/FDIC/CPA

- **Get the Facts**

- How Material? Nature/Purpose of Transactions?
- Regulatory View? Technical Matter vs. Intent to Mislead?
- Who Investigates? Audit Committee/Full Board?
- How? Internal Investigation/Independent Counsel?
- Confidential Contact with Other Bank Officers?
- Role of Independent CPA?

- **Risk Assessment**

- Financial Risk? Impact on Earnings & Stock Price?
- Legal Liability? Shareholder Litigation?
- Regulatory Liability? Material Weakness? Fines?
- Reputational Risk? Adverse Publicity?

- **Action**

- CEO/CFO Reprimand/Resignation/Termination?
- CEO/CFO Bonus "Claw Back"?
- Assess Role of CPA Firm/Other Experts

# Internal Controls

## Suspected Internal Fraud

- **Get the Facts**
  - Source? Internal Audit/Bank Exam/CPA/"Hot Line"?
  - Nature of Suspected Fraud? Who/What/When?
  - Who Investigates? Audit Committee/Full Board?
  - Confidential Contact with Other Bank Officers?
  - How? Internal Investigation/CPA/Independent Counsel?
  
- **Risk Assessment**
  - Legal Liability? If Suspicion is False/Accurate?
  - Financial Risk? \$ Amount/Insurance?
  - Regulatory Liability? SOX 404/Material Weakness?
  - Reputational Risk? Adverse Publicity?
  
- **Action**
  - Regulatory Notification? SAR?
  - Law Enforcement?
  - Disclosure?

# Regulatory Problem

## “Failed” Exam: Your Bank Receives MOU/C&D

- **Get the Facts**
  - Nature of Criticism? Management/Credit/Operations/Technology?
  - Identify: Management Responsibility/Accountability?
  - Who Investigates? Audit Committee/Full Board/Special Committee?
  - How? Internal Investigation/Independent Counsel?
  
- **Risk Assessment**
  - Legal Liability? Bank/Individual Board Members?
  - Regulatory Liability? Civil Money Penalties? SOX 404?
  - Financial Risk? Bank/Individual Board Members?
  - Reputational Risk? Adverse Publicity?
  
- **Action**
  - Management: Fix the Problem!
  - Board: Evaluate the People/Systems – Replace?

# Problems Happen!

Be Prepared - Problems are Easier to Address  
When Your Board Is Already Doing  
"The Right Things Right"

- **Regular Executive Sessions**
  - Established Process/Every Board Meeting
  
- **Established Committee Structure**
  - Nominating & Governance
  - Audit – Financial Reporting & Internal Controls
  - Compensation – People & Employment
  
- **Availability of "Independent" Advice**
  - Independent Legal Counsel – Board/Audit/Compensation
  - Independent CPA – Audit/Board
  - Compensation 'Expert' – Compensation Committee/Board
  - Financial Advisor/Investment Banker – Board
  - Final Decision is Board Responsibility – Experts Only Advise!

## Minimize Litigation Risk

- **Your Board's Dilemma When Things Go Wrong:**
  - You Need to Get the Facts to Make Appropriate Decisions – But:
  - The “Facts” You Uncover and Documents [a] You Prepare may be Subject to “Legal Discovery” & Potential Public Disclosure.
- **Your Board's Challenge is to Conduct an Appropriate Investigation - Without Increasing the Bank's Potential Liability to Regulatory Action or Shareholder Litigation.**
- **Boards are Well Served by having Sensitive Investigations Conducted by a Law Firm – Including Oversight of the Investigations Conducted by “Independent Experts”.**
- **Most Communications Between Your Law Firm and Your Bank are Considered “Privileged” - Take Care to Protect this Privilege!**

[a] Minutes, Written Reports, Personal Notes, Email, etc.  
Remember Anything and Everything Can be Taken Out of Context!

## **Your Personal Challenge**

- ✓ **Taking Appropriate Action**

**To Address an Unexpected Problem**

- ✓ **Appropriate Action is a Function of  
Your Board's Collective Good Judgment**

- ✓ **You Can't Legislate "Good Sense"**

- ✓ **No "Right Answer" for Every Bank**

**Each Bank Board is a Unique Blend of Talent and Personality**

## Role of “Independent” Advisors

- Do Board Members Really Need Independent Advice?
- How do You Avoid Board/Management Conflict?
- What are Your Legal Responsibilities?
- What Advice Should You Obtain? How Often?
  - Legal Counsel
  - Compensation Consultant
  - Financial Advisor
- How do You Select “Independent” Advisors?
- How Do You Measure Cost/Benefit?

## Charles J Thayer

Charles J. Thayer is Chairman and Managing Director of **Chartwell Capital Ltd.**, a private NASD member investment firm that provides executive management and board members with specialized advisory services on governance, strategic planning, financial, investment and compensation matters.

Chartwell also provides financial institutions with analysis and advice concerning strategic alternatives. The **American Banker** and **Bank Director Magazine** both ranked Chartwell among the nation's Top Financial Advisors in 1998 and 2001.

The **American Association of Bank Directors** named Thayer to its Board of Advisors in 2004. The AABD is a national non-profit organization serving the information, education and advocacy needs of financial institution directors.

Thayer's combination of executive management and board experience brings a unique perspective to Chartwell's advisory services. He served on the board of **Republic Bank** (NASDAQ) in Florida from 1999 until 2004 and continues to serve as a board member of **BB&T Bank (Florida)** following BB&T's 2004 acquisition of Republic Bank. He currently serves as a board member of the **Louisville Community Development Bank** in Kentucky (1986-present) and for the national **Cystic Fibrosis Foundation** (1980-present).

Previous board service includes **CogenAmerica** (NASDAQ) (1996-1999), an independent multi-state cogeneration power producer headquartered in Minnesota, and **Sunbeam Corporation** (NYSE) (1990-1997), an international consumer products company. He served as Chairman and interim CEO of Sunbeam in 1993. John A. Byrne (Business Week) described Thayer as Sunbeam's "most knowledgeable director" in the book "Chainsaw". He also served as an advisory board member of **Keefe Managers** (1989-2002); a New York based bank stock hedge fund founded by Harry V. Keefe.

Prior to organizing Chartwell Capital in 1990, Thayer had a twenty year career in commercial banking. Thayer served as Executive Vice President and Chief Financial Officer of **Citizens Fidelity Corporation** (NASDAQ), Kentucky's largest bank holding company until its acquisition by **PNC Financial** (NYSE) in 1986. Following the acquisition Thayer was elected Executive Vice President of PNC (1987-1989) with management responsibility for finance, merger and acquisitions, investor relations, strategic planning, and PNC's capital markets subsidiary, serving as Chairman of **PNC Securities Corp.**

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