

# **Federal Home Loan Bank of Seattle**

**2006 Management Conference**

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*Reputational Risk*

*'When Things Go Wrong'*

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***Welcome!***

**Today's Program Will Address**

**Appropriate Board Action**

***'When Things Go Wrong'***

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

## ***Your Financial Institution's Reputation?***

- **What is a 'Good Reputation'? (Your Mother Knows!)**
  - ✓ **Your Most Valuable Assets!**
  - ✓ **Trust** ✓ **Credibility** ✓ **Confidence** ✓ **Integrity**
- **Task is to Achieve/Maintain a 'Good Reputation' with:**
  - ✓ **Public & Potential Customers**
  - ✓ **Existing Depositors/Customers**
  - ✓ **Management & Employees**
  - ✓ **Vendors & Suppliers**
  - ✓ **Marketing Partners**
  - ✓ **Regulators**

## ***Financial Services Reputation?***

- **Fortune Magazine's Reputation Index\***
  - ✓ Real Estate & Home
  - ✓ Stores & Distributors
  - ✓ Power (Enron!)
  - ✓ Electronics & Equipment
  - ✓ Computer & Communications (Worldcom!)
  - ✓ Consumer Products
  - ✓ **Financial Services**
  - ✓ Natural Resources
  - ✓ Transportation
  - ✓ Media & Entertainment
  - ✓ Outsourcing & Healthcare
- **Not the Strongest Position if a Problem Develops!**

\* Fortune Magazine's 2005 Most Admired Companies  
Industry Average Reputation Index

## ***Reputational Risk***

***Viewed as a Significant Potential Risk  
by Bank Regulators***

***“Reputational risk is generally of utmost importance to financial institutions because of the central role public confidence plays in their success.”***

**FDIC**

***“Reputational risk is the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions.”***

**Federal Reserve Board**

## *Reputational Risk*

### *'When Things Go Wrong'*

- **Who's Reputation is at Risk?**
  - ✓ **Your Financial Institution?**
  - ✓ **Your Institution's Management?**
  - ✓ **Your Institution's Employees?**
  - ✓ **Your Institution's Board Members?**
  - ✓ **All of the Above!**
  
- **Not Just a Regulatory Risk!**

## *Reputational Risk*

### **Bad Things Can Happen When Trust is 'Broken'**

- **Deposit Outflow - Liquidity Risk!**
- **Potential Customers - Impact Future Growth**
- **Employees - Ability to Attract & Retain Talent**
- **Shareholders - Negative Impact on Stock Value**

## *Reputational Risk*

### **Is it Really that Critical?**

**Ask these Board Members about Negative Publicity!**

**Adelphia  
Calpine  
Cendant  
Enron  
HealthSouth  
Martha Stewart  
Sunbeam  
Tyco  
Worldcom**

**AIG  
Arthur Andersen  
Gold Bank  
H & R Block  
Putnam Funds  
Mass Mutual  
New York Stock Exchange  
Refco  
Riggs Bank**

## ***Reputational Risk***

***Bad Things Can Happen to Good Companies!***

**'Hope' is Not a Plan - Avoid Thinking:**

*"That sort of thing won't happen at our bank."*

*"We are smart and nimble and can react quickly."*

**Ill-Advised Action in Response to an Unexpected Problem  
can Create Reputational Risk and Legal Liability for  
Individual Board Members, Officers and Employees.**

**Many 'Crises' Start as a Manageable Problem!**

## *Reputational Risk*

### *How Do You Prepare for the Unknown?*

- **Regulators Require Financial Institutions to have Better Risk Management Identification Systems than Most Organizations.**
  - ✓ Risk Management Identifies Potential Problems
  - ✓ Effective Risk Management Helps Avoid Problems
  - ✓ Effective Risk Management Helps Identify Solutions
  
- **Unknown Problems Create Unexpected Risk.**
  - ✓ Know Who to Contact if a Problem Occurs
  - ✓ Identify Resources Needed to Address Such Problems
  - ✓ Focus on Solving the Problem
  - ✓ Identify Resources Required for Public Response

## *Reputational Risk*

### *The 'Public Relations' Challenge*

- **What Happened? What Action is Being Taken?**
- **What do You Say? Who Says It? Where? When?**
  - ✓ The Difference Between a Media Trained Spokesperson and One Who is Not Trained is Painful to Watch.
  - ✓ A Poorly Presented Public Response can Contribute to the Perception of a Greater Problem.
- **Never Engage in a 'Cover-Up' (Remember Watergate)**
- **The 'Right' Spokesperson and a 'Great' Presentation is Not a Substitute for Solving the Problem.**
- **The CEO Should Always Manage the Process – Unless the Issue Involves the CEO.**

## *Reputational Risk*

### *Dealing with the Media*

- **Designate One Spokesperson**
  - ✓ No 'ad lib' comments by Others
  - ✓ Refer ALL Contacts to Spokesperson
  - ✓ Report All Attempted Contacts to Spokesperson
- **Give Every Media Contact the Same Information**
  - ✓ Each Will Try to Obtain "Exclusive" Information
  - ✓ Avoid "Playing Favorites" – Competitors Can Retaliate
  - ✓ Avoid Regulatory Violations – Bank & SEC Rules
- **Keep to the Facts – Avoid Excessive Commentary**
  - ✓ Expect to be Quoted "Out of Context"
- **Never Engage in a 'Cover-Up'**
  - ✓ Correct Inaccurate Information Before it's Discovered by the Media
  - ✓ Your Reputation is based on Trust, Credibility, Confidence, Integrity

## *Reputational Risk*

- **Let's Examine How Your Bank Might Address the Following Scenarios:**
  - ✓ **False Information**
  - ✓ **External Problem**
  - ✓ **Internal Problem**  
**CEO Not a Problem**
  - ✓ **Internal Problem**  
**CEO Is The Problem**

## ***False Information***

*Loan Problem/Management Problem/Fraud/Acquisition?*

**The Most Significant Test of Your Existing Credibility!  
Everyone Will Suspect It's a 'Cover-Up'**

- **Get the Facts (Make Certain It's False!)**
  - ✓ Target of False Information? CEO/Bank/Employee/Customer?
  - ✓ Who Investigates? (Depends on the Target)  
Management/Board/Special Committee?
  - ✓ How? Internal Investigation/Independent Counsel?
- **Risk Assessment**
  - ✓ Reputational Risk - Impact of Adverse Publicity?
  - ✓ Legal/Regulatory Liability? "Be careful what you say!"
  - ✓ Financial Risk?
- **Action**
  - ✓ Regulatory? Bank/SEC?
  - ✓ Spokesperson? CEO/Board Member/PR Person/Legal?
  - ✓ Degree of Reaction? Address the Question - Don't "Feed" the Media!

## ***External Problem***

***Vender Problem/Internet Intrusion/Customer Fraud/Natural Disaster?***

- **Get the Facts**
  - ✓ Who Investigates? Management/Board/Special Committee?
  - ✓ How? Internal Investigation/Independent Counsel?
  - ✓ Internal/External Experts?
  
- **Risk Assessment**
  - ✓ Financial Risk? To Customers? The Bank? Insurance?
  - ✓ Legal/Regulatory Liability? To the Bank/To the Board?
  - ✓ Reputational Risk? Impact of Adverse Publicity?
  
- **Action**
  - ✓ Regulatory? Bank/SEC?
  - ✓ Spokesperson? CEO/PR Person/Legal?
  - ✓ Disclosure? Internal/External?

## ***Internal Problem***

***CEO is Not the Problem/Employee Fraud/Lost Laptop?***

- **Get the Facts**
  - ✓ Who Investigates? Management/Board/Audit Committee?
  - ✓ How? Internal Investigation/Independent Counsel?
  - ✓ Risk Evaluation? Internal/External Experts?
  
- **Risk Assessment**
  - ✓ Financial Risk? Insurance?
  - ✓ Legal/Regulatory? To the Bank/Officers/Employees/Board?
  - ✓ Reputational Risk? Impact of Adverse Publicity?
  
- **Action**
  - ✓ Regulatory? Bank/SEC?
  - ✓ Spokesperson? CEO/PR Person/Legal? (NOT a Board Member)
  - ✓ Disclosure? Internal/External?

## ***Internal Problem: CEO!***

***'Personal Relationship' – Suspected Fraud – Leadership Failure?***

***'Tone at the Top'***

- **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/Regulatory Liability? What If Information is False/Accurate?
- ✓ Exposure to Employment Litigation?
- ✓ Reputational Risk? Adverse Publicity?

- **Action**

- ✓ Reprimand/Resignation/Termination?
- ✓ Regulatory? Bank/SEC?
- ✓ Spokesperson? CEO is NOT the Spokesperson  
Board Member/PR Person/Legal?

## ***Problems Happen!***

***Be Prepared - Problems are Easier to Address When  
Your Board Is 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 Decisions are 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!

## ***Role of 'Independent' Advisors***

### ***Board's Need to Ask and Answer These Questions***

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

## ***Personal Challenge for Board Members***

### ***How Do You Determine 'Appropriate Action'?***

- **Educational Programs (Today) Can Help Board Members Enhance Their Personal Knowledge and Skills**
- **Appropriate Action Requires 'Good Judgment'**
  - ✓ Congress Can't Legislate 'Good Judgment'
  - ✓ Programs Can't Teach 'Good Judgment'
- **Appropriate Board Action Requires the Collective Good Judgment of All It's Board Members**
- **Every Board is a Unique Blend of Talent & Personality**
- **No "Right Answer" for Every Board**

## *Personal Challenge for Board Members*

### *A Final Thought*

- **Most Bank Board Members Serve on Multiple Boards**
  - ✓ Business & Corporate
  - ✓ Charitable & Non-Profit
  - ✓ Professional & Educational
- **Unexpected Problems Can Occur at Any Organization**
- **Never Take a Board Membership for Granted**
- **Every Board Seat has Reputational Risk**
- **'Best Practice' is a Universal Board Concept**

## Charles J. Thayer

Charles J. Thayer is Chairman and Managing Director of **Chartwell Capital Ltd.**, a private investment firm that provides specialized advisory services to executive management and board members of commercial banks, corporations and institutional investment clients.

Chartwell Capital's investment banking services focus on merger and acquisition advisory services for financial institutions. The **American Banker** and **Bank Director Magazine** both ranked Chartwell among the nation's Top Financial M&A Advisors in 1998 and 2001.

The **American Association of Bank Directors**, a national non-profit organization serving financial institution directors, named Thayer to its Board of Advisors in 2004. He is also a founding board member of the **National Association of Corporate Directors** Florida Chapter.

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". Thayer 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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