

# Surviving the Crunch: What's a Board to Do?

*Larry Cabaldon*

*Presented to CBA Directors & CEO's*

# Board Challenges

- What are the most important things boards do?
- What lessons are to be learned from recent events and history?
- How to ensure your board is effective?
- How to improve your board's effectiveness to meet key objectives in 90 days?

# What Do Boards Do?

## Provide Adult Supervision

### The duty of care and loyalty.

- **Protect**

- Protect your organization and your assets.

- **Prosper**

- Create wealth

- **Perpetuate**

- Stewardship for shareholders, regulators, employees, customers, community and your good name.

# Board Role

## The Board's Responsibilities

- Protect, Prosper and Perpetuate
- Results through:
  - Strategy - Create, approve, insure execution
  - CEO - Hire, fire, guide, motivate and pay
  - Maintain highest standards, oversight standards, monitor, ensure, and proactively take action.

### Tested by

- Economic, regulatory environment, and governance expectations
- Company performance past and projected
- Industry and bank complexity
- Relationship with CEO

### Goal: Proud Leadership Legacy

# **Creating a proud leadership legacy**

- 1. Take the lead by assuming responsibility**
- 2. Assess the board and executive performance**
- 3. Hold to the highest standards**
- 4. Focus on the intangibles**
  - a) Winning
  - b) Harmony
  - c) Attitude
  - d) Trust
  - e) Right things
- 5. Set and achieve five objectives every 90 days**

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# **The Goal**

**Create a proud leadership legacy  
of growth, value and integrity**

***Or remember: “Age and treachery will always  
overcome youth and skill. B.S. and brilliance  
only come with age and experience.”***

**What are the Lessons  
Your Board Needs to Learn From  
Recent Events and History?**

# Current Headlines

- CEO succession at Merrill, Citi, Countrywide
- Fraud at Societe Generale
- Regulators berating agencies' AAA for CDO's and Mortgage-Backed Securities
- BofA and WAMU directors under fire for purchase of securities
- Vineyard former CEO's proxy fight for new slate of directors and reinstatement
- Bear Stearns
- WAMU Compensation Plan which ignores key facets of performance
- Executive Management turnover
- Q2/07 and Q1/08 Bank financials

# Lessons/Patterns - 1

**Check out** <http://www.fdic.gov/bank/historical/history/vol1.html>

- “Dead Bank Walking” by Robert H. Smith, Former Chair/CEO of Security Pacific Bank
- S&L Debacle: Over 1000 S&L’s failed
- Banking credit crunch 1980-90s: 1600 banks failed
- Sub prime meltdown: 12/22/07 [The Economist](#):  
Estimated sub prime defaults would reach between U.S. \$200 -300 bn.

# Lessons/Patterns - 2

## Pattern for Boards

- Banks allowed to pursue new markets, products, methods,
- Banks innovate and leverage to make large profits
- Real estate key risk area
- Economy crashes
- New products are disastrous, effect everything
- Regulators overreact
- Boards under severe pressure on performance metrics and governance blame
- CEO's fired, banks in chaos, banks closed/merged, more rules
- Lesson - You're responsible!

<b>Pattern</b>	<b>S&amp;L Debacle</b>	<b>1980-1990 Downturn</b>	<b>Today</b>	<b>Board</b>
Regulators Allow	Entry into real estate development, new products	Entry into non bank, real estate concentration	Sub prime AAA ratings, real estate concentration	Boards compete within guidelines innovation, high leverage
Banks push hard to compete	S&L major expansion	Aggressive non bank subs, real estate lending	Securitized loans, real estate lending	Boards encourage aggressive goals
Economic Downturn	Loans to developers default	Subs in trouble real estate tanks	Both sub prime and real estate crashes	Boards concerned about performance
Key Product creates disaster other sources of income hurt	Industry in major trouble	Heavy losses new ventures and real estate	Heavy losses, failure to repay Capital/liquidity/earnings issues	Boards under pressure to perform
Regulators Overreact	RTC, FDICIA FIRREA	Decline in value of collateral	Begin tightening up credit, capital etc.	Regulators start blaming boards and pressure starts
Banks Punished	Industry destroyed	Banks forced to merge	Coming regulatory requirements	CEO fired, chaos, bank sold, more regs

# When Boards Need to Act

<b>Cruising</b>	<b>Concerns</b>	<b>Crisis</b>
Metrics on plan	Metrics Shaky	CAMEL 4-5
No pressures, urgency	Pressures starting	90 day windows
Retreats, conferences	Special Meetings	Emergency meetings
Regulators visit	Regulators directing	Regulators adversarial
How to pay, bonus, stock options	How do we justify compensation	Immediate capital infusion required
Plan annual meeting	Defend at annual meeting	Report merger, new investor/owner, need for capital, or resignations
Relax, no action or General Evaluation	More urgent evaluation and action steps	Turnaround Mode in 90 Days

# How Would you Describe the Characteristics of the Current Banking and Governance Environment?

- Speed, complexity
- Uncertainty
- Shareholder Activism
- Capital Pressures
- Interest Margin Squeeze
- Regulatory Pressure
- .....

# What Skills, Qualities, Qualifications Does a Board Need to be Effective in this Environment?

e.g.

- CAMELS-"Balanced Scorecard"
- 9 Categories of Board Effectiveness
- 100% Competent Leadership Team
- WHATR5

# **CAMELS**

**How do you rate? 1-5**

- **Capital**
- **Assets**
- **Management**
- **Earnings**
- **Liquidity**
- **Sensitivity to market risk**

# Board Effectiveness

## On-Line Assessment

### Board Composition

- *Talented directors who contribute*

### Board & CEO Compensation

- *Pay for performance*

### Strategic Planning

- *Focused plans for success*

### Board Procedures

- *Eliminated wasted time/energy*

### Board Interaction

- *Ability to harmoniously work together*

### Board Information

- *Relevant information for decision making*

### Board Committees

- *Improved delegation for better results*

### Board and CEO Effectiveness

- *Defined roles for effectiveness*

# Assessing Board Effectiveness Sample

## ***Board Composition***

- Our board is made up of qualified members
- The board has the appropriate mix of skills and experience
- We have identified the necessary skills and knowledge we must have on the board.

## ***Board & CEO Compensation***

- Our CEO's current compensation package is fair and competitive.
- Our CEO's compensation is tied to the performance of the bank as it relates to our strategic plan
- The board is compensated with the appropriate amount of non-cash compensation

# **Assessing Board Effectiveness Sample.....**

## ***Strategic Planning***

- The organization is achieving its strategic goals.
- The CEO has a strategic plan that has been approved by the Board.
- The CEO regularly updates Board members on progress of the strategic plan.

## ***Board and CEO Effectiveness***

- The overall performance of the board is very effective.
- The overall performance of the CEO is very effective.
- The effective interaction of the Board and CEO has resulted in the successful execution of our strategic plan.

# WHATR5:

## Quick Assessment/Action Plan

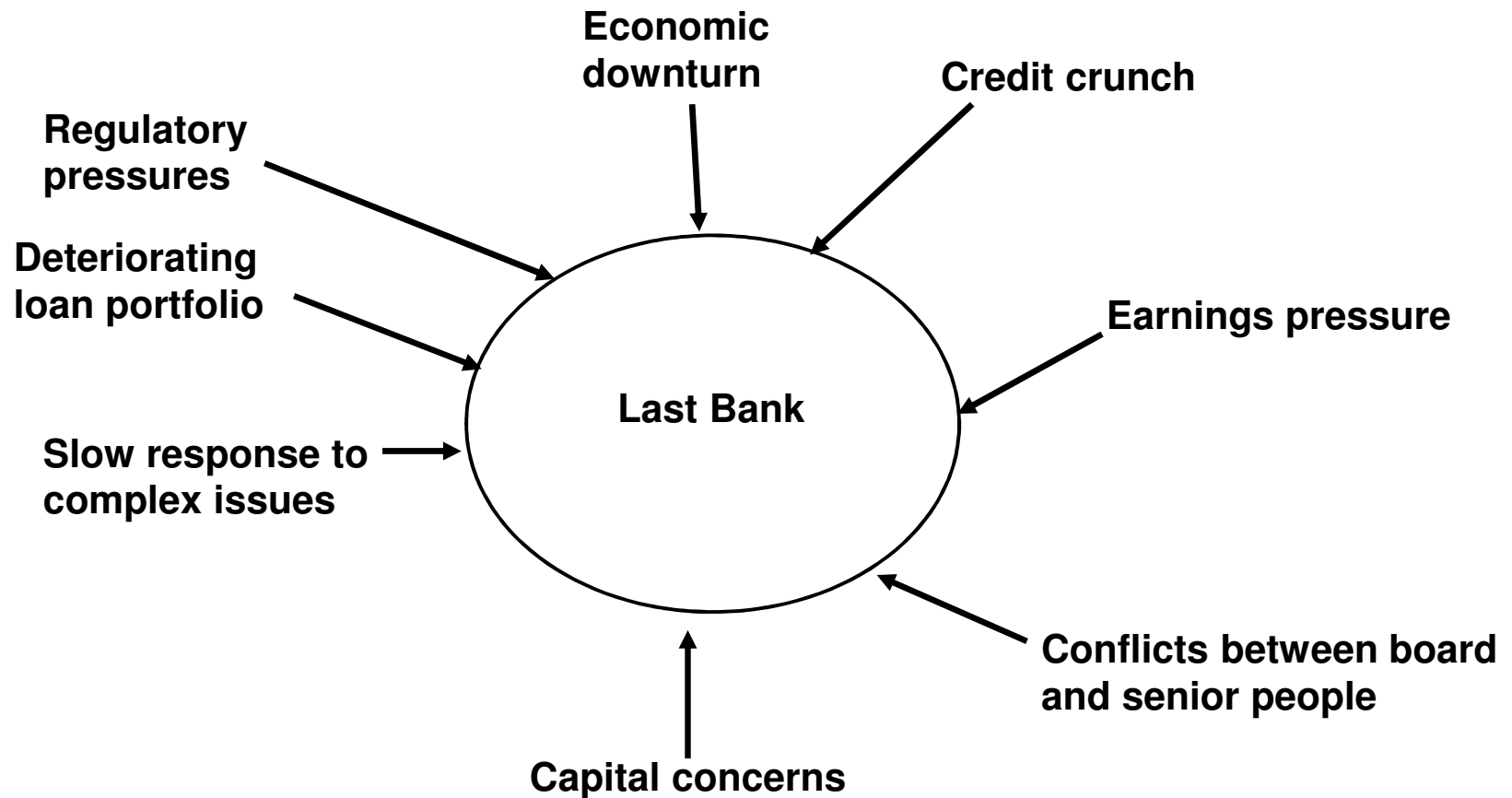
- **Winning**
  - Are we meeting the financial and other objectives?
- **Harmony**
  - Are we in agreement and working together effectively to meet objectives?  
Board dynamics.
- **Attitude**
  - Do we have negative or positive, aggressive attitudes?
- **Trust**
  - Are we telling the truth, committed and credible?
- **Right Things**
  - Are we doing the right things in terms of strategy, speed, right people/  
right positions, use of information, risk management, committee  
structure, succession planning, values/ethics and compliance?
- **5**
  - What are 5 objectives we can achieve in 90 days that would  
demonstrate our performance and have major impact.

# WHATR5

## Turnaround Case Study

- Company performance
- CEO, key executive, and key managers' performance
- Key functions: audit, operations, finance, human resources, marketing, sales, R&D etc
- Board effectiveness

# Pressures Impacting “Last Bank”



# Background - 1

## **Bank founded in 1980**

- Top quartile of peers in performance
- Tremendous growth and success
- Outstanding profit until 2007
- CEO with Company since 1999 excellent performance until 2006

## **Problems began to surface**

- Credit crunch caused by sub prime crisis
- Deteriorating loan portfolios
- Lack of adequate financial reporting and early warning
- CAMELS rating 4-5
- Economy into recession
- Inability to book new loans
- Overemphasis on real California real estate
- Board under severe criticism from investors/shareholders/regulators
- Infusion of capital required

# Background - 2

## **Regulators Express Concern**

- Bank not hitting projections for 2008
- Concern about capital and liquidity
- Search for scapegoat
- Tightening up of credit standards
- Auditors restate earnings
- Reevaluation of real estate collateral
- Bank moving to crisis
- Consultant retained to review and analyze

## **Pressures for greater disclosure and accountability**

- Key performance factors continue to decline.
- Board concerned about CEO ability to lead and manage challenges, credibility of financial information, and management of work outs
- Key executives begin to leave the bank.
- Board receives notice of mandated assessment.

# Board - 1

## Qualifications

- Founding, long term directors with strong community business and real estate backgrounds.
- Lack of strong knowledge and interest in banking.

## Performance to date

- Proactive board involved in investment/loan/compliance issues.
- Negative attitude towards regulators.
- On learning curve with new challenges facing bank.
- Do not actively demonstrate knowledge or provide direction at committee meetings.
- Over-reliance on knowledge of real estate market and character of customers instead of cash flow analysis.
- Conflicts of interest causing regulatory scrutiny with damaging results.
- Board dissension weakens board oversight effectiveness in dealing with issues.

# Board - 2

## Responsibility

- Oversee bank management.
- Make investment decisions.
- Monitor and approve loan decisions and credit quality.
- Comply with regulatory requirements.
- Protect shareholder and depositor interests and perform fiduciary duties.

## Future issues

- Create high performance, team oriented bank culture.
- Improve composition and effectiveness of Board.
- Eliminate real and perceived conflicts of interest and dissension among directors.
- Ensure Bank profitability and regulatory compliance.
- Raise level of CEO and Bank management performance.
- Raise level of bank and board effectiveness in finance, management information, goals, budgets, response to issues.
- Help CEO and Bank meet five objectives.

# Chairman of the Board - 1

## Qualifications

- Former banker, good background
- Original founders group
- Familiar with lending issues
- Strong leadership personality

## Performance to date

- Tremendous effort in making changes working board, moving bank forward
- Over relied on key officers
- Well regarded
- His own failing business requiring full time focus so not providing leadership to help bank

# Chairman of the Board - 2

## Responsibility

- Oversee board and management
- Develop strategic goals
- Monitor progress and controls
- Coordinate, board, management and outside resources
- Lead and manage current crisis

## Future Issues

- Improve board's role in overseeing management and helping the bank recover.
- Develop more professional relationship between board, senior management and outside sources.
- May have to be the interim CEO.

# President/CEO - 1

## Qualifications

- Well experience bank executive, but lacks turnaround experience with troubled Bank
- With Bank from 1999.
- Visionary, growth oriented, aggressive in developing innovative programs

## Performance to date

- Strong impact on Bank until unprofitable in 2005
- Well regarded by Board
- Hired well qualified executives
- Perceived as no taking strong leadership under adverse conditions.
- Key areas of strategic disagreement with board
- Regulators unhappy
- Board under pressure to replace him

# President/CEO - 2

## Responsibility

- Lead/bank into new areas
- Objectives
  - Fix OREO
  - Earnings
  - Regulatory compliance
  - Develop agreed upon strategic response to economic conditions
  - Protect bank from loss
  - Build organization capability to address turnaround crisis.

## Future Issues

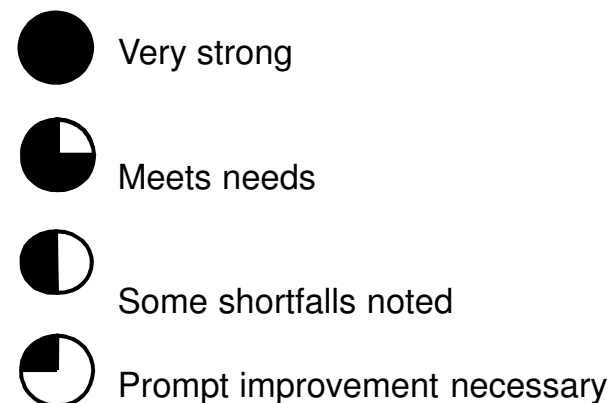
- To survive, must demonstrate strong leadership of Bank
- Gain board support of new initiatives.
- Show immediate positive changes.

# Executive Performance Criteria

Results Achieved	Qualifications	Leadership Effectiveness	Management
<ul style="list-style-type: none"> <li>• Completes assigned work</li> <li>• Meets or exceeds position requirements</li> <li>• Achieves objectives</li> <li>• Accountable</li> </ul>	<ul style="list-style-type: none"> <li>• Experience</li> <li>• Technical knowledge</li> <li>• Track record</li> <li>• Skills</li> <li>• Fit in culture organization</li> </ul>	<ul style="list-style-type: none"> <li>• Motivates others to achieve results</li> <li>• Vision for future goals</li> <li>• Personal impact</li> <li>• Resolves conflicts</li> <li>• Builds teamwork and commitment</li> <li>• Instills positive attitude</li> <li>• Develops staff</li> </ul>	<ul style="list-style-type: none"> <li>• Has specific goals objectives/time frames/plans</li> <li>• Allocates resources effectively</li> <li>• Monitors progress</li> <li>• Sets standards of performance</li> <li>• Achieves results through others</li> </ul>
Team Player	Attitude	Business Development	Growth Potential
<ul style="list-style-type: none"> <li>• Committed to team values/goals</li> <li>• Cooperative, responsive team member</li> <li>• Trustworthy to meet commitments</li> <li>• Fosters group harmony</li> <li>• Well regarded</li> </ul>	<ul style="list-style-type: none"> <li>• Positive</li> <li>• Loyal</li> <li>• Committed</li> <li>• Service oriented</li> <li>• "Can do" approach</li> </ul>	<ul style="list-style-type: none"> <li>• Generates business</li> <li>• Participates effectively in customer retention</li> <li>• Contributes to general marketing efforts</li> </ul>	<ul style="list-style-type: none"> <li>• Willingness to learn new concepts and skills</li> <li>• Growth oriented</li> <li>• Key role in succession plan</li> </ul>



# Status of Key Functions

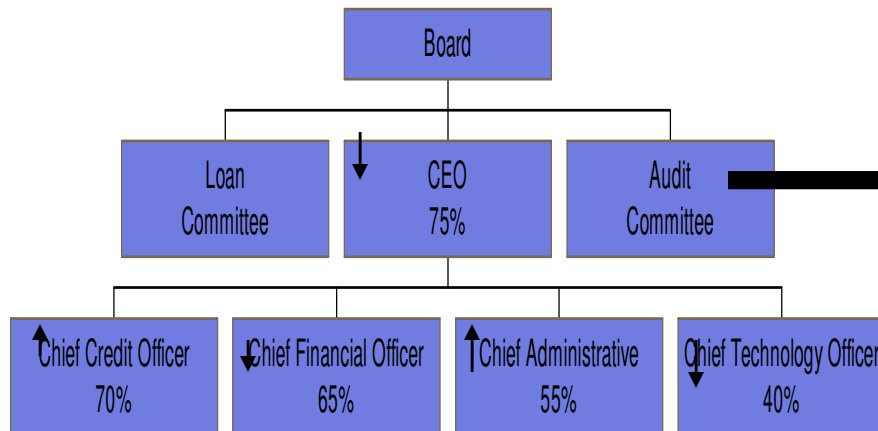


	Name	Status	Comments
<b>Finance</b>	Jones		Bean counter function. Numbers have no credibility
<b>Audit</b>	Smith		New financial expert, independent, changed auditors
<b>Real Estate</b>	Black		Shifted into special assets significant improvement
<b>Risk/compliance</b>	White		Understaffed, lack board support
<b>Credit</b>	Brown		Sales oriented, Needs redirection, ineffective workout strategy

# Boards Rating: 100% Competent Leadership Team

Performance

Strategy



2XR	ASSET	TURN	DIVEST	EXIT

Service Providers /advisors rating

60%

# **How to Improve Board/Bank Performance for Immediate Results**

- **5 objectives:**

What are the five objectives that would significantly improve bank and leadership performance in next 90 days?

# **Improve Leadership and Board Effectiveness - 1**

## **Management**

### **Demonstrate rehire commitment.**

- Gain commitment from CEO and two SVP's to new plans and objectives.
- Form Executive Officer Committee to meet weekly to establish goals and monitor progress.
- Conduct monthly officer meetings to communicate and commit all bank officers.
- Set standards and demand improved staff performance.
- Develop greater sense of urgency, focus and teamwork.  
Balance individual goals with Bank wide success.

## **Measure of Success**

- Achievement of objectives by CEO, management team and Board.
- Demonstrated effort, teamwork, and leadership.

# Improve Leadership and Board Effectiveness - 2

## Board

### Rehire CEO

- Gain input and commitment from board on CEO objectives.
- Improve Board committee effectiveness.
- Use strategic plan process to upgrade Board's knowledge and participation.
- Provide business like analysis of issues, alternatives, strategies with documented discussion and decisions, and tracking.
- Use financial diagnostic, budgets, plans, etc. to improve the professionalism board oversight.
- Board education program.
- Have Board conduct self assessment of effectiveness and commit to improvements.

### Measure of Success

- Achievement of objectives by CEO, management team and Board.
- Demonstrated effort. teamwork. and leadership.

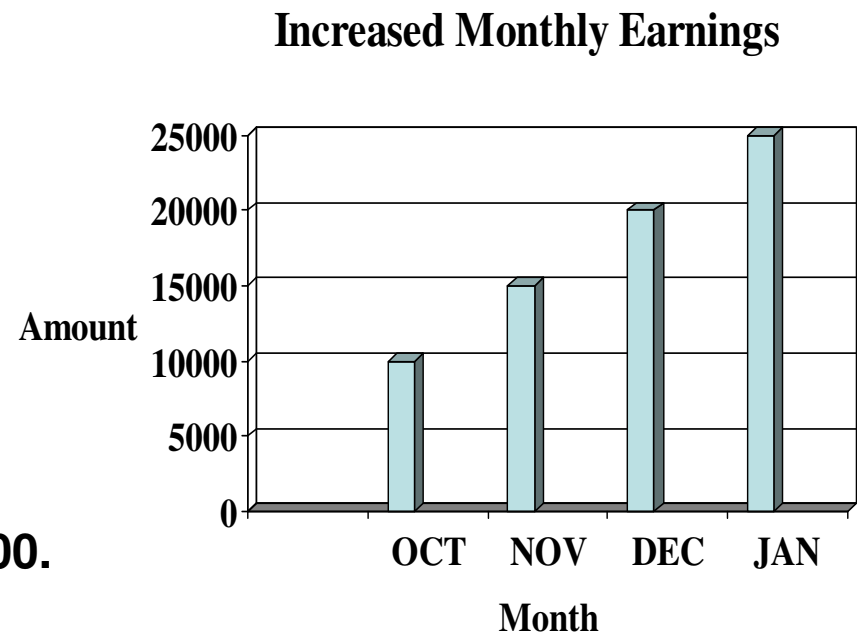
# Improve Earnings

- **Executive team will develop specific plans covering:**

- Bank strategy.
- Analytical tools for decision making.
- Expense analysis including staffing, advertising, premises, etc.
- Review of pricing of all services and relationships for profitability.
- Increase earning assets.

- **Key measures**

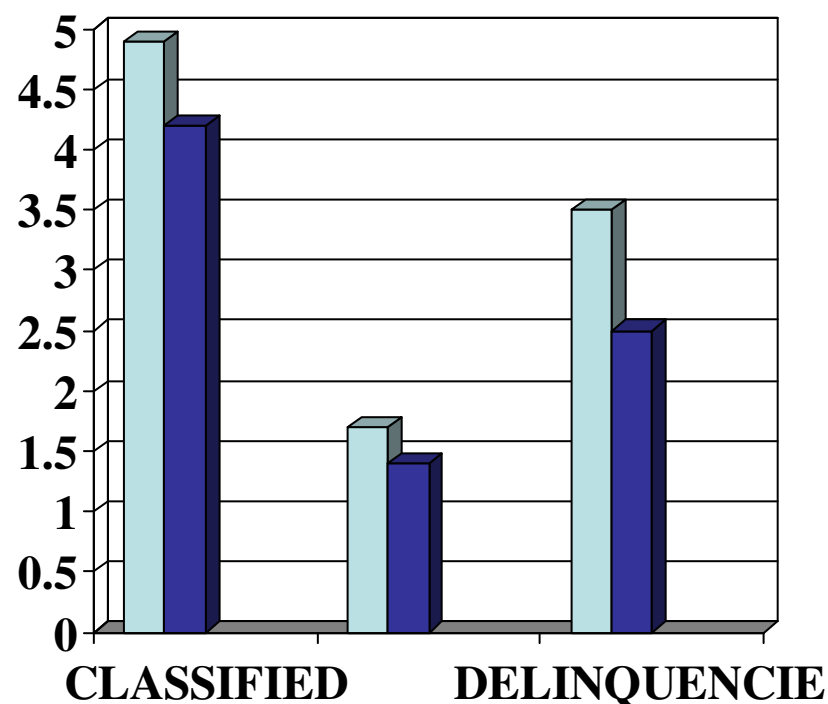
- **Monthly earnings** - Increase to **\$25,000**.
- **ROE** - increase from negative (-0.7) to **positive 7.4** annualized, by 1/31/09.
- **ROA** - Increase from negative (-0.006) to **positive 0.006** annualized, by 1/31/09.



# Improve Classified Asset Quality

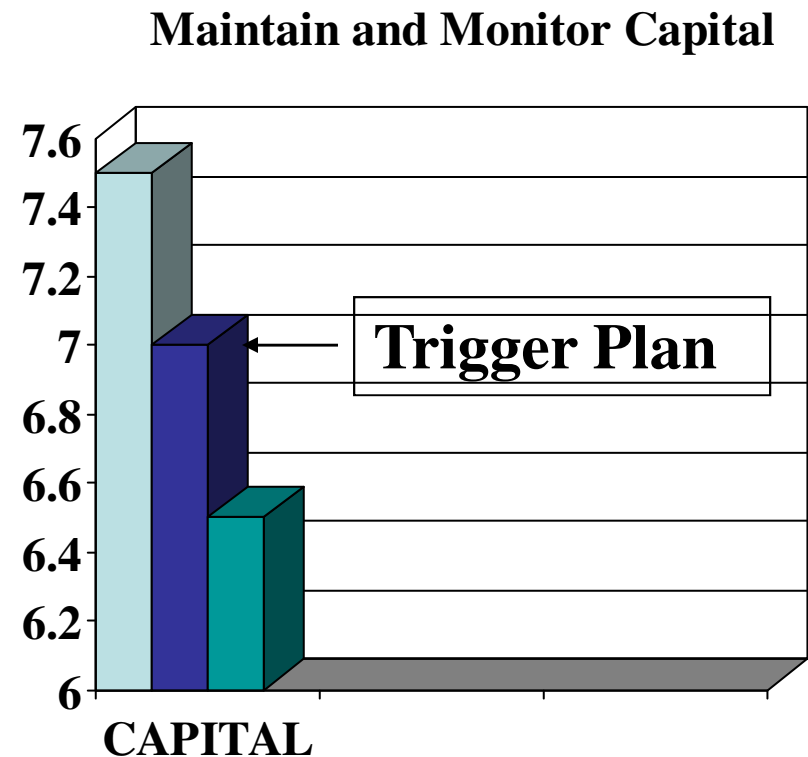
- **Establish Loan Task Force:**  
to focus on asset quality - includes CEO, CFO, and CLO and loan officers.
- Concerted team effort, involving executive officers of bank, to meet these objectives.
- **Key measures**
  - **Classified Loans-** Reduced by \$200,000 per month. \$4.9 to **\$4.2 million** by 1/31/09.
  - **Non-Accruals** - Reduced by \$100,000 per month. \$1.7 to **\$1.4 million** by 1/31/09.
  - **Delinquencies** - Reduced from 3.5% to **2.5%** by 1/31/09.

Asset Quality Targets



# Maintain Adequate Capital

- **Bank's capital position:**  
Executive team, through improved classified asset quality and earnings, will maintain and improve the bank's capital position.
- **Capital plan** will be established and monitored. If capital falls from 7.5 to 7.0, that "trigger point" will initiate the contingency plan to raise capital.
- **Key measures**
  - **Maintain capital at 7.5% or better.**
  - Progress of asset quality and earnings improvement objectives.
  - Monitor "trigger point" with contingency plan backup.
  - Success in raising capital, if necessary.
  - Reduction in assets.
  - Minimum 6.5%, 7.0 triggers plan
  - objective 7.5 or better.



# Ensure Regulatory Compliance

- **Executive Officers Committee:**

Will develop a comprehensive list of all compliance issues/directives.

- All issues will be assigned, tracked and monitored by the Executive Officers Committee and the Board.
- Early warnings of non-compliance will be discussed documented, and corrected.

- **Key measures:**

- Completeness of list.
- Action plan, accountability, and deadlines.
- Monitoring and corrective action taken.
- **100% compliance** by 1/31/09 on outstanding issues.
- Future exam results.

# Commitment of Leadership Team

We, the leadership team of Last National Bank commit ourselves to working together to meet these objectives by Jan. 31, 2009. Success or failure will be a team effort. Each of us will perform our roles to the fullest and support each other in achieving these objectives.

**Signed:** *Joe Jones*  
*Bob Smith*  
*Vicki Black*  
*Karen White*  
*Jim Brown*

# Quick Final Test

What are Your Bank's 5 Objectives?

- As a director can you list in order?
- Does this match the other directors?
- Does this match your CEO and executive team?

# Takeaways

1. Can you respond?
  - ◆ Speed of Change-Crisis one quarter = one year?
2. Do you know how to manage the outside forces?
  - ◆ Multiple regulators, market, activists and investors?
3. Is your board capable, knowledgeable and skillful for the tasks?
4. Do you know the strengths and weaknesses of management and advisors?
5. Do you have the key talent to be successful?
6. Using the wisdom of lessons learned, are you focusing on the key, essential issues?

# Takeaways

## Determine Your Effectiveness

1. M in CAMELS
2. Your board effectiveness rating
3. What is your leadership competency percentage?

## Take Charge to Perform

1. Improve board effectiveness ratings
2. Three areas to strengthen
3. WHATR5 are you focusing on the critical issues?

## What's your next step?- Are you Ready?

***Of those to whom much is given, much is required. And when at some future date the high court of history sits in judgment on each of us - recording whether in our brief span of service we fulfilled our responsibilities, success or failure, we will be measured by the answers to four questions--***

- Were we truly men of courage?**
- Were we truly men of judgment?**
- Were we truly men of integrity?**
- Were we truly men of dedication?**

**John F. Kennedy**