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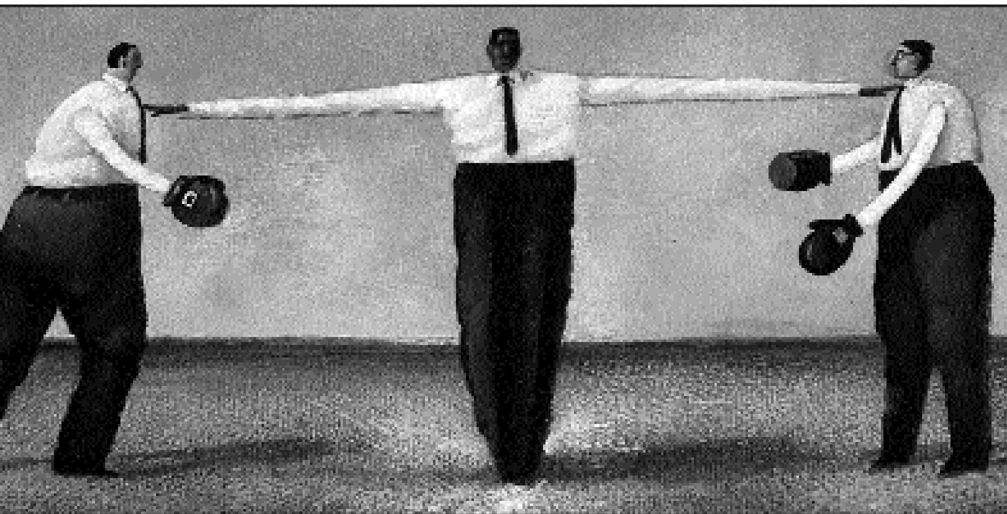
You and Your Board

What do you do with a "problem director"?



It is always assumed that the directors of financial institutions get along well with one another and that there is no discord, contention, or adversarial relationships within the board.

Too bad that isn't true!

Many reading this article are directors of financial institutions, and know how unrealistic it is to expect complete togetherness of your board. Bank directors are human beings first, and directors second.

Occasionally a director will go "bad," even without embezzling or misappropriating funds. A director may simply become a destructive liability to the board rather than a constructive asset. If such a director makes an appearance on your board, the sooner you resolve the situation, the better off you will be.

Does your bank board have a problem director, or what I call an "ugly director" (with apologies to *The Ugly American*)?

***By Dr. Douglas V. Austin**, president and CEO, Austin Financial Services, Inc., Toledo, Ohio. Dr. Austin is a veteran consultant to banks and boards.*

What makes a problem director?

The "average" board consists of 7 to 9 white men aged 60 or older. In many community banks, diversity is still defined as having six Methodists and two Presbyterians—*not* as having directors in their 40s who are of other religious backgrounds or who are women or minorities.

Such homogeneity is not accidental, but neither is it anti-social or blatantly racist. The homogeneity reflects the long-term, traditional attempt to have a board of like minds and personalities. The more a board consists of directors with common roots or business, social, educational, and cultural connections, the more likely the board will be able to work together with minimal conflict. Thus, it is not unusual to find many boards consisting of directors from the same high school, college, church, or country club.

As a result, the bank finds itself with a group of directors who have grown to a mature age together. They are now in their 60s and 70s, with no new blood on the board. They are silently scared to break up the nucleus of camaraderie that binds the board through the introduction

The seven breeds of ugly directors

"Ugly" directors come in a wide variety. The following is by no means an all-inclusive list, but merely good examples of conduct not in the best interest of corporate governance:

The big mouth. This director can be easily identified at board meetings, outside of meetings, and even throughout town. He or she talks loudly, often, and obnoxiously about what is happening within the board, at the meetings, and at the bank. Directors are expected to keep their own counsel and be discreet. *A big-mouth can often cause problems that are correctable through strong leadership by the chairman, beginning with discussions with the problem director.*

The irrational, illogical director. Over a considerable period, this director has developed a mistaken belief that: the board is out to get him or her; certain directors have it in for him or her; or that the board is doing things that are unconscionable, unethical, and illegal and must be stopped. Assuming this director is not certifiably insane, he or she become so paranoid that there is no simple solution. Such a director has a tendency to withdraw, conspire, and often attempt to divide the board by pitting one director against another. *Other than removal, there is no best method for resolving this disruptive situation. This type is often not worth salvaging.*

The nonstop talker. This director just does not know when to shut up. He or she simply argues or disagrees meeting after meeting, even when the discussion has been terminated through a formal vote. The dead situation is brought up time after time by this character, who can go back six months on issues already decided.

Such directors are so full of themselves that they feel they must impart

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ILLUSTRATION BY DAVE CUTLER

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of new ideas, new thoughts, new business practices, and, especially, younger ideas from younger people.

However, now and then a director will go off the deep end. This is more than someone who disagrees with the majority—it is someone who acts irrationally and illogically. If a board member suffers from mental incapacity, physical infirmity, or worse, if you cannot figure out what the problem is, and the director becomes a disruption at meetings— that is a problem director. (See the box, "The seven breeds of ugly directors," p. 16.)

> **"If bylaws do not contain a clause permitting the board to remove a director 'with or without cause,' then removing a director that becomes a problem will not be permissible"**

Before we go further, let's be clear about something. All members of the board have a responsibility to voice their opinions, and have the duty to operate in a fiduciary capacity they believe is best for the banking institution, its employees, creditors, and its shareholders. No director should be a sheep following the dictates of the CEO or others. If you act like a sheep, you may end up looking like a goat.

Thus, disagreements among board members, although they are not encouraged, are a responsibility of the board and a right to pursue if such disagreements arise. Any board that has never had any disagreements is being manipulated by the CEO or majority shareholder.

The difference between a disagreement and a disruption is in the tone, severity, and length of the contention.

If your board has reached a situation where one director becomes contentious, disagreeable, and a problem to control, regardless of how often and intensely you have attempted to rectify the situation, then you have a problem director. A decision must be made to either salvage or remove the problem director before the environment and productivity of the board is destroyed.

What can and can't be done

As a corporate board, yours may have painted itself into a corner as a result of previous actions prior to the time a particular director became a problem. For example, if the bylaws do not contain a clause permitting the board to remove a director "with or without cause," then removing a director that becomes a problem will not be permissible. Thus, a review of the bylaws will determine whether the board has the right to remove an offending director. If directors are elected or appointed for a specific term, this might also prohibit removal until the term has expired, especially if there is no provision for removal with or without cause.

Along this same vein, a mandatory retirement age can be either a blessing or a curse. If an offending director is not nearing the mandatory retirement age, and again, there are no provisions for removal, that director can stand for re-election until retirement age. If no mandatory retirement age is in force, then simply do not renominate the director for the next term. (A mandatory retirement age highlights a presumption of credibility until age 70 or 72, and removal of a director prior to that age would raise significant questions within your community, which both the board and the director would prefer to downplay or even ignore.)

If your bank board operates under cumulative voting requirements, like all national banks, then a problem director who has significant ownership can remain on the board until he or she decides to quit.

When a big shareholder is a problem

As noted above, if your board operates under cumulative voting, the director who has significant ownership of your bank will remain on the board regardless of what you do, as long as the director has enough shares to re-elect himself each year. There have been several instances I've seen over the last 30 years, where this scenario was the cause of the problems.

There is almost no way to salvage such

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a situation. Such directors control the situation—*unless* the board can find legal or business reasons for removal for cause. In essence, the board would need to make sure that the problem director would be banned from banking, the director's conduct having been so onerous that he or she would be removed prior to regulatory authorities banning them from banking.

In my experience, this has never been the case, and in the cases I have reviewed or been involved in, the director was obnoxious, disagreeable, but significantly wealthy and simply could not be removed.

I am often asked what can be done in such a situation: The obvious answer is that the other directors should quit and go home!

In such cases where I have been involved, the significant shareholder-director who became the nexus of controversy wound up being the sole director, which obviously caused regulatory problems. It should be noted that in both of the cases I am familiar with, the remaining board members had little ownership and thus had very little financial incentive to stay. In cases where there are other significant shareholders/directors, it seems logical that such controversy would end up in the courts rather than having other directors/shareholders simply resign and disappear.

Impact of problem directors

The box on the opening page of this article details seven common types of problem directors. If your board has found itself with a problem director, you know full well that the worst of such directors is disruptive, disagreeable, and contentious. They can ruin the efficiency of board meetings. Even if the problem director cannot force the defeat of various motions, the atmosphere within the board can become so frosty and disruptive that the problem director will succeed in destroying productivity without winning a single vote. A problem director can so poison the atmosphere that the effectiveness of the board disintegrates, with potentially disastrous impact on shareholders, employees, and the community.

This type of disruption and anarchy necessitates "sacking" the problem director, since salvaging is a condition that has long become hopeless. At this point, a responsible member of the board, normally the chairman, would be in touch with the bank's counsel to determine the rights of the majority against the problem director in order to resolve the situation. When rational discussion and schmoozing are over, the only solution is direct action.

How to get rid of a problem director

Be forewarned, there is no way to get rid of a problem director easily and without much fuss. Assuming that the problem director is not the chairman, then the person most logically in charge of getting rid of the problem director *is* the chairman.

Assuming there are no constraints in removing the director, it is one of the functions of the chairman to confront the problem director and discuss the situation directly. The chairman must then inform the director that he or she will not be renominated and that they should resign as promptly as possible.

If the direct approach does not work—and it often does not—then the corporate governance statutes and accompanying rules and regulations are your second line of defense. Utilize legal counsel to assist. (If legal counsel serves on the board, then you must utilize special counsel as your board member/lawyer will have a conflict of interest.)

Utilizing the advice of counsel, which may vary from state to state due to individual state banking and business laws, you do not renominate the problem director for the next year or term. You may even need to go so far as to immediately eliminate the director with or without cause from the board.

If the board members believe they can remove one of their own without hurt feelings, stressed friendships, or leaks—the directors are sorely misinformed and naïve.

Thus, each board member must decide: Do I want to tolerate the intolerable within the board room? Or do I want to get rid of the ugly director even if it causes short-term community reaction,

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all their knowledge and expertise to fellow directors all the time.

If you have such a director, how do you get him to quit talking?

First, the chairman must run the meeting appropriately, making sure that all directors get an opportunity to discuss subjects brought before the board.

Second, the chairman can put a time limit on discussion. This is mechanical, but it is better than letting a nonstop director drone on.

Third, if the first two approaches did not work, the chairman must meet with the nonstop talker and tell him or her that such domination of discussions is unacceptable and that he or she must learn to participate as a team member, not as a star. If the discussion goes well, the problem should be solved. If not, then suggest clearly that renomination is not a real probability.

The tattletale. Confidentiality is a basic, fiduciary duty of a director. Breaches of confidentiality cannot be tolerated; otherwise the board and the bank may become subject to liability from customers whose information has been disclosed. Few directors breach confidentiality, in all likelihood as the result of strong educational activities within the board.

However, if a director discloses information that is confidential outside of the bank, the director becomes a problem and may only be salvageable if such disclosure can be terminated with the first exposure. If the director is counseled by the chairman (or other appropriate members of the board or legal counsel) and the situation persists, then the only choice is to remove the director.

The angry director. On occasion a director "loses it" within the board environment and expresses himself venomously in harsh tones, using expletives and other inappropriate

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loss of friendships, and extreme stress? That is a judgment call and that's what the shareholders hired each director to do.

How to orchestrate removal

Informality is the best approach to the situation at least initially. If the chairman is the appropriate person to talk to the offending director, then it could be one-on-one over a cup of coffee at the director's business or a local watering hole subsequent to a meeting. If the offending director has a close friend who also serves on the board, the chairman might invite that person into the equation to help reconfirm the situation during their discussion. In some communities, the spouse may be introduced into the discussion with the offending director. Spouses are more aware than they are given credit for, and if the director is physically or mentally infirm, not caring, nonresponsive, nonparticipative or nonprepared, the spouse will know the situation as clearly, if not more so, than the board.

Including the spouse in the discussion *may* actually help alleviate the offensiveness of the removal process, but it could also backfire. This is a judgment call by the chairman and the rest of the board.

All of these options have the characteristic of informality. If that does not work, and the director refuses to resign or retire even with a guarantee of an elaborate farewell party, then you will be forced to eliminate the director through formal actions. This may take more time and will certainly be more costly.

Impact upon the community

In my consulting with community banks, I have encountered at least a dozen occasions where directors have commented they are afraid to remove one of their own because it will cause a significant adverse reaction in the community. They are concerned customers will pull their money and no longer deal with the financial institution if they ask good old Tom (who hasn't been able to find the board meetings for five years) to leave the board.

In general, this is total nonsense and heifer dust! This is a cop-out for not making a decision that may bring stress upon the directors within the community. Unless the offending director is deity-like, removal will cause little problem within the community. In fact, in many cases, board members will be asked what them took so long.

While it is true that the removed director will probably pull his deposits, he won't pull his loans. If capable of doing so, the removed director will probably badmouth the bank for a foreseeable period of time. What you do not need to worry about is whether anyone is actually listening

Regulatory impact

If the state or federal regulatory agencies

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A literal doomsday scenario for bank boards

If there is anything worse than one obnoxious, problem director, it is two or three. A bad situation can multiply from a simple, one-director problem to the board finding itself broken into two or three factions.

This situation, though infrequent, can and does happen through the inappropriate handling of the removal of the first problem director. The longer the problem continues, the more exacerbated the problem and the more likely it becomes that factions will develop—one that wants to dump the director immediately and another that comes to the director's defense.

If the situation reaches this point, the board has completely mishandled removal of the problem director. When you reach this stage, it is essential that you get outside assistance before the board totally self-destructs. A splintered board can destroy a bank in less than a year. ***—Dr. Doug***

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behavior. Whether this is merely a reflection of personality and individual demeanor and not that of a physical or mental disorder, such conduct might become so disruptive that the director should be promptly removed from the board. *However, if such behavior is the result of medication complexities, physical infirmities, or mental incapacity, then removal from the board for a short period of time until the situation can be corrected may be in order.*

The forgetful director. People age at different speeds, and often signs of some mental infirmities may be more obvious in some people than others. If a director begins to exhibit a lack of mental clarity as a result of the aging process, dementia, or Alzheimer's disease, the director has probably reached the point where he or she needs to be counseled to step down from the board. As a board member, you should be able to tell when a fellow director no longer acts the same, misses meetings (forgetting when they are held), or seems to be unprepared or uninterested when present. *Under those circumstances, the director is more a pity than a problem, but the ultimate solution is to retire the director with honor and replace with a new, fully motivated and mentally clear individual.*

The "who cares?" director. There are always going to be directors who just don't seem to give a darn anymore. They have retired and spend more time playing golf, gardening, or simply drinking at the country club than being involved in community activities. They come to board meetings unprepared, do not participate, and essentially grab their paychecks and leave. You will not find them involved with bank functions and have no interest in a director's educational seminar. *It is time for this uninvolved individual to leave. Do not renominate them unless you believe they are salvageable and you are prepared to discuss this with them frankly.*

—Dr. Doug Austin

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have found a condition of unsafe or unsound banking that is directly tied to an individual director and recommend voluntary removal of that director in lieu of banishment from banking, such removal is absolutely necessary. Being banished from banking through a public determination is not an action any director would want on his record. A voluntary resignation or retirement from the board with a formal, private determination that the director not apply for membership on any other federally-insured financial institution would be a plea bargained compromise. It would be of no benefit to your board to fight such a regulatory determination.

Moreover, if your bank is under a memorandum of understanding, letter agreement, or cease-and-desist order, not only is removal of a director a possibility, but anytime you want to appoint a new director, you must receive permission from the state and federal banking regulatory agency involved. The regulators in this capacity are certainly going to be very concerned about the quality and capabilities of suggested director candidates and may even veto individuals they do not believe will add expertise to the board.

Finally, would the regulators get involved in settling a situation within your board by trying to work out compromises and solutions when the board is at odds?

Generally, no. There are state and federal laws and rules and regulations affecting the safety and solvency of your bank, but there are no rules and regulations concerning the conduct of board meetings and the degree of togetherness of your board members. In fact, some regulatory agencies might have the same kinds of disagreements among their own staff members that you have at your board level.

No one can force you to get along. The regulatory authorities can remove individuals who are offensive to banking from your board, but they certainly cannot get it to operate efficiently and productively.

However, before we leave this subject, it should be noted that if you need expertise and knowledge concerning what might be done if there is a problem director, conversations with your examiner or a senior regional regulator you have worked with over the years is an appropriate way to gain information or network contacts to obtain the expertise necessary to solve the situation. Do not try to dodge the bullet, but there is no point in shooting yourself in the foot trying to solve the problem without help. ***BJ***