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Following this letter is a sample copy of the newsletter, and a special order form. The form will also allow you to subscribe to *ABA Bank Directors Briefing* for your board in print form, at our regular rates, if you prefer the print edition.

Sincerely,

Steve Cocheo
Editor
ABA Bank Directors Briefing

ABABANK DIRECTORS BRIEFING

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THE DIRECTOR'S JOB

WHERE ON THE "SPECTRUM" DOES YOUR INSTITUTION'S SUCCESSION PLAN RESIDE? AND WHERE *SHOULD* IT?

Succession management is no luxury. The unpredictable nature of both business and life make it so.

"Succession planning is one of the most fundamental responsibilities of a community bank board. Any bank board that makes no effort to ensure leadership continuity by identifying and developing leadership talent assumes a much higher degree of risk for its continued viability."

So says the introduction to ABA's *The Board's Role in Management Succession Planning*. The handbook is the eleventh unit in the ABA's *Community Bank Directors Workshop* series of handbooks on director and trustee issues. It draws on a wide variety of industry literature to present a unified approach to this challenging, and often touchy, issue.

IS YOUR BOARD THE 1 IN 3?

In spite of the importance of management succession planning, the booklet notes that one out of three community banks' boards haven't touched the matter. Author Stanley Ragalevsky, partner in the Boston office of the K&L Gates law firm, suggests that directors determine if they sit on the 33% of boards that haven't paid attention to succession by asking if any of these questions have been discussed recently:

- The talents and skills a CEO must have to be able to lead your bank.
- How those talents and skills are likely to be different tomorrow.
- What the board and your CEO are doing to develop the other officers.
- The capabilities of your senior management team to implement fundamental

THE DIRECTOR'S JOB continues on p. 3

DEAR DIRECTOR:

Regulatory Reform Debate Takes Center Stage In A Year Of Many Industry Priorities

In years past, tracking banking legislation as it made its way through Congress resembled glacier-watching. Viewed up close, in the daily fray, one could discern movement. But when the camera pulled back to get the whole picture, the perception of motion slowed to a crawl.

Not so with banking reform this year. In the wake of crisis, while things have slowed down a bit, the pace remains quite remarkable, considering the scope of change under consideration.

One can truly say this time around that if one blinks for more than one beat, one may miss something significant.

The sheer volume of data, testimony, reports, and counter reports being issued out of and in the nation's capital concerning banking matters this year is staggering.

In an Aug. 4 statement before a hearing, Senate Banking Committee Chairman Chris Dodd (D.-Conn.), with a mixture of pride, fatigue, and frustration in his voice, said: "This is the 24th hearing we have held this year on modernizing financial regulation." (On Aug. 5, the 25th was held.) The House Financial Services Committee and other congressional bodies have maintained an equivalent record. The regulators and the bank lobbying corps have been earning their pay in spades this year.

And bankers and directors are being asked to do more for theirs, and for the future of their industry, too. See the box on page 2.

There's so much going on, it's like

trying to keep an eye on every ring of a Ringling Brothers show.

Things sort out into roughly three stages: affairs dealing with the stabilization of the banking system through the capital infusion efforts and the ripples from that; affairs dealing with proposed reform of the federal financial regulatory system; and the "ordinary" flow of regulatory rules and guidances, cranked up to higher speed in the aftermath of the mortgage crisis and more.

"One can truly say that if one blinks for more than one beat, one may miss something significant"

Stabilization costs

Regarding the first issue, the matter of the federal efforts to stabilize the banking industry has been sending

ripples in many directions. Over the course of this year there will be more of them, and they will combine with other trends in Washington. Much can be said of this, but compensation is one very notable aspect of what will be affected. Many banks are likely to see their affairs dictated, or influenced, in some fashion, over time.

In June, Treasury Secretary Timothy Geithner announced five principles for financial services compensation. "The financial crisis had many significant causes," he stated, in introducing them, "but executive compensation practices were a contributing factor." Risk management plays a part in most of the five principles, which are:

1. *Compensation plans should properly measure and reward performance.*
2. *Compensation should be structured to account for the time hori-*

BY THE EDITORS OF ABA BANKING JOURNAL

ABA stresses that the August congressional break is the opportunity to influence the critical legislation now in play. The association has made it easy for bankers and directors to send comments to Congress on this legislation. Use the following speedlink: <http://tinyurl.com/DirectorComments>

zon of risks.

3. *Compensation practices should be aligned with sound risk management.*

4. *The assumption that golden*

parachutes and supplemental retirement packages align the interests of executives and shareholders should be reexamined.

5. *Transparency—and accountability—should be promoted in the process of setting compensation.*

Already, recipients of government capital aid under the federal TARP program have run into compensation restrictions and requirements and objections with the government. In terms of board duties, for instance, compensation committees for TARP recipients face such must-dos as reviewing their institutional compensation programs—the overall programs, not just those for senior executives—every six months.

It is generally acknowledged that this is a beginning of things to come. In early August, the House passed H.R. 3269, the Corporate and Financial Institution Compensation Fairness Act. Under this financial-services-specific legislation, public banks would have to have advisory votes by shareholders on compensation and golden parachutes—*this is the so-called “say on pay.”* Their board compensation committees would have to be made up of independent directors, and compensation consultants would have to demonstrate independence from management as well. (The concept is somewhat like the independence requirement imposed on public firms’ audit committees under the Sarbanes-Oxley Act.) In both cases, there would be provisions for smaller companies.

Another piece of the same bill would require banks and other financial firms of more than \$1 billion in assets to disclose incentive-based pay arrangements to their federal regulators. And for those institutions, banking regulators would be required to proscribe compensation plans seen as being imprudent or inappropriate.

Senate Banking Committee Chairman Chris Dodd favors such legislation, and is expected to pick it up after the August break.

House Financial Services Committee Chairman Barney Frank (D.-Mass.) remarked in recent speech that shareholders *had* to be involved because, in his view, directors can’t do the job.

“We have the radical notion on the Democratic side that the shareholders who own the company ought to be able to set outer limits on pay,” said Frank. “That’s because the notion that it will be done by the board of directors is fruitless because boards of directors and CEOs are inevitably the closest of collaborators. There is not, and should not be, an adversarial relationship between the CEO and the boards of directors. I think it’s impossible to structure one in a well-functioning organization. It’s a mistake to think that one day a year, they’ll go to arm’s length and be labor and management.”

Something else to be aware of: In a recent ABA America’s Community Bankers Council director telephone briefing, ABA’s Sally Miller, speaking on compensation issues, predicted that in time much of what you’ve just read would filter down to cover nonpublic banking companies as well. Miller is senior vice-president in ABA’s Center for Securities, Trust, and Investments.

Reshaping banking regulation

Earlier we remarked about blinking, and it was perhaps understatement.

In only weeks, the nature and shape of the debate over reform of the banking regulatory apparatus has been through a breakneck evolution.

- When the Obama Administration introduced its long concept paper for reform—*Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation* in the latter part of June, it initially appeared to have no vocal opposition other than from the banking lobby, notably ABA. Some saw the initiative of the Administration as so preemptive that announced hopes of rapid passage seemed realistic.

- But only weeks later, by the time of ABA’s summer Leadership Meeting, where various ABA councils and representatives of state bankers associations gather to deliberate policy, matters had evolved. When House Financial Services Committee Chairman Frank introduced his bill based on the Obama blueprint, he left out segments dealing with the Community Reinvestment Act, for instance. (He believes CRA, very important to him, should be addressed separately.) Then the banking regulators, initially quiet about the proposal, began to register some objections to the plan, while supporting others. There were strong feelings about some aspects of the proposed Consumer Financial Protection Agency, the subject of the July newsletter, for instance.

- This led bankers who went to Capitol Hill for ABA to return with somewhat more optimism about congressional willingness to tinker with the Administration plan than had appeared to be the case initially. Beyond the proposed consumer agency and some sympathy for banking’s preference that safety-and-soundness regulation and consumer regulation not be separated, there was support for the industry’s opposition to the Obama plan to

combine the Comptroller's Office and the Office of Thrift Supervision. This would create a unified regulator of national banks, while also phasing out the federal thrift charter, under the Obama proposal.

- But, as we said, change continues to grind along in Washington.

Momentum has slowed, but motion continues faster than the norm.

- In late July, Frank gave a landmark speech on regulatory reform. Among the points he made—which the Treasury Department is also pursuing in different venues, including a fat reading package offered to Senators as they left for summer break—is the claim that the proposed consumer financial agency would be good for community banks.

"We can set up a consumer protection agency that will respect all of the community banks," said Frank. "They were not the perpetrators of the abuses; they will not be the subjects of the corrections. And they need to work with us to help us do that."

(Many community bankers we've talked to on this would not agree.)

Frank also addressed the Obama plan to have the proposed agency prescribe "plain vanilla" products that anyone offering a particular type of service on their own would also have to offer. Frank dislikes that and indicated it would not likely be in final legislation.

- Then, *The Wall Street Journal* carried an article that told an unusual Washington insider's tale, of a meeting called by Treasury Secretary Timothy Geithner of financial regulatory agency chiefs. There, he chewed them out—allegedly with speech laced with bad language—for getting involved in their own "turf" issues and not getting on board the Obama plan.

- Later that week, at the Aug. 4 Senate Banking Committee hearing referred to earlier, Ranking Republican member of the committee, Richard Shelby of Alabama, pointedly asked the regulators about the influence of the Geithner criticism. All denied any

THE DIRECTOR'S JOB (CONT'D.)

changes in strategy if that is what is needed to make your bank successful.

- Whether your bank should look internally or externally for its next CEO.

- Preparation of a management skills inventory and/or development plans for your bank's senior managers.

"If your board has not had a serious discussion about at least two of these issues," writes Ragalevsky, "it needs to start thinking much more seriously about succession planning."

Management succession issues can come up in unexpected ways.

- *We recently talked to officials of a community bank where the longtime CEO, expected to serve for years yet, had a stroke, took a leave of absence, and later decided, for the bank's sake, to leave the acting CEO, who had been groomed to take over someday, in place. The bank had had a plan, and, though it was triggered by unexpected circumstances, it worked as desired.*

- *Another bank recently interviewed had succession forced on them as the result of a regulatory order. The new president came from existing staff, but it was unclear whether that might have been a stopgap, rather than a result of a contingency plan.*

FIND YOUR PLANNING PLAN

Ragalevsky gives extensive material for reflection and presents appendices with helpful checklists and sample forms to help a board new to succession planning get moving, and to give a board that has at least made a stab at it something to measure its own efforts against.

But an important point to determine, whether the board has taken no steps or done the basics, is where on the spectrum of planning the bank sits. Ragalevsky notes that a frequent point of confusion lies in that "there are several different definitions for the term."

At the level of bare essentials, for instance, there is what he calls "replacement planning." This is almost not planning at all. It covers only the CEO, is reactive to events, rarely involves the current CEO in the effort, and, in general, is a weak corporate governance approach.

Ragalevsky talks of the other extreme, which is "succession planning

Succession aids from ABA

Is your board going to get serious about succession? Or is it, but it wants yardsticks?

- The 32-page guide discussed in the main column, *The Board's Role in Management Succession Planning*, can be purchased from ABA's website in packs of ten with a discussion leader's guide and a discussion presentation for the leader's use, on CD. The cost is \$295 for the package, discounted to \$195 for ABA members. Go to www.aba.com/Products/CBDW_11.htm to order. To find out about other units in the series, go to www.aba.com/Solutions/BankDirectors.htm

- You can order a CD of the America's Community Bankers Council director telephone briefing, "Directors and Management Succession: Picking Your Bank's Next Leaders," at www.aba.com/teleweb/tb091907.htm

and development." This comprehensive approach looks at the management team, not just the CEO. It formalizes the board's approach, looking not only at what each position under examination requires now, but what ways the successor may have to be different. Current holders of the chairs being planned for likely have a voice in the process, and the aim is generally to grow talent for succession from within.

"An organization cannot ... quickly implement a succession planning and development approach," writes the lawyer. "It takes time, commitment, resources, and scale to successfully implement a meaningful development program within an organization." He adds that for smaller community banks, this ideal approach may not be practical or affordable.

What's the alternative between these extremes, then? Ragalevsky refers to it by the generic title for this discipline: "management succession planning."

"This pragmatic hybrid approach to succession planning recognizes that smaller organizations typically have neither the resources nor the manpower to develop successors internally, but need a succession-planning process," he writes. The process looks at how to replace members of the top team, to ensure continuity and adaptability, and involves the board in many points from a policy and planning view, and forms the meat of the ABA handbook.

impact, after having already given formal statements that indicated that their positions had not changed from earlier testimony.

- Shelby, for his own part, remarked that it was important that all parties understand that, “ultimately, it is going to be *Congress* that will set the tone and set the laws.”

- *Indeed, speaking of setting the tone, the hearing that day had opened with a statement by Chairman Dodd that threw a bit of a curveball.* He brought up a new point in the current debate—though not a new idea—why not consolidate the regulatory agencies, instead of just joining the Comptroller’s Office and the thrift agency? This was resisted by the regulators appearing on the panel before Dodd that day.

- FDIC Chairman Sheila Bair pointed out that compared to other sectors, “the banks have held up pretty well” under the current regulatory scheme. And Comptroller John Dugan noted that a former Comptroller once said of the federal system, “It doesn’t work in theory, but we work hard to make it work in practice.”

- The efficacy of state regulators, the issue of states’ rights, and the purpose and need of having both state and federal banking system, as well as the interplay of state and federal banking law and regulation have all come up in the debate. So has the oversight—in theory and in actual practice—of “shadow banks,” the thousands of nonbank organizations that do banking business without exams or much if any oversight.

- And the final form of the systemic risk protection measures contained in the legislation loom as well. Much argument and work remain. The final outcome: Anybody’s guess.

- *Regarding timing.* Frank expects the various sections to pass the House in September and October. Meanwhile, Dodd expects his committee will begin addressing legislation in September. Both anticipate having final legislation to the President before yearend.

And then there’s new and old burdens

Regarding the third issue, regulatory overflow, it’s not your imagination. There is a double shipload of stuff to be handled. Surely you’ve noticed that your bank’s staff is far busier these days, and not just with a more challenging business environment and a tougher-to-handle loan portfolio. The load of regulations to be addressed and complied with, especially those involving home lending, a major community

ABA director phone briefing focuses on exams

On Sept. 23 ABA’s America’s Community Bankers Council presents the next in its Director Telephone Briefing Series: “Directors and Regulators: Understanding the Examination and Enforcement Process.” Speakers include Jeffrey Gerrish of Gerrish McCreary Smith LLC consultants and Pat Rohan of FinPro, Inc. The 90-minute briefing will run from 2:00-3:30 P.M. ET. Go to www.aba.com/teleweb/tb092309.htm to register.

bank activity, have grown tremendously. And this comes on top of a regulatory burden many bankers from institutions of all sizes have long groaned under.

In a recent ABA America’s Community Bankers Council telephone briefing concerning regulatory issues, ABA’s Robert Davis, executive vice-president, mortgage markets, financial management, and public policy, told listening directors that while board members often hear complaints from Compliance, Operations, and senior management about getting it all done, things have changed.

“They *really do* have a legitimate complaint in this instance,” said Davis. “There is a huge increase in regulatory burdens in the mortgage space coming along. .. And the problem is they are all coming at the same time.”

In the course of his presentation, Davis listed all the regulations that bankers are preparing for, or will have to be preparing for. He commented, “regulations that are coming that are going to transform the mortgage transaction. In some ways they may transform the whole business model, depending on how they come out.”

He and his fellow speakers spent nearly 90 minutes just scratching the surface of the current challenge.

Among the many “routine” issues—as opposed to revamping the regulatory system itself—aired:

- The evolving treatment of capital and sources of liquidity by examiners.
- Coming changes in the regulation of credit cards and overdraft protection plans.
- Pending regulations dealing with anti-money-laundering matters.
- Expanding regulatory interest in new products such as remote deposit capture, and the risk of new attention if banks mess up with “social media” such as Twitter and Facebook.

Sincerely,

Steve Cocheo

for *ABA Banking Journal*

P.S. To order a CD of the entire 90-minute presentation, go to www.aba.com/teleweb/tb070809.htm

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