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# THE SYNOVUS SETTLEMENT: A CORPORATE GOVERNANCE VIEW

The case isn't quite as it's been reported, but there are good reminders here

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This is a companion to a Talking Credit blog by Ed O'Leary, which addresses this case from a credit perspective.

Have you heard about the Synovus Financial Corp.'s settlement of its shareholders' derivative action, *Miller v. Anthony et al.* in the Federal District Court for the Northern District of Georgia? I thought it had some interesting issues that were worthy of note.

## The basics of the case

The matter is a shareholder's derivative action, i.e., one shareholder files an action on behalf of the corporation against its directors, officers, etc. (This is only generally allowed after the shareholder makes demand on the board of directors to sue itself and the board refuses. Often, as occurred in the Synovus case, the board "refused" the demand to sue itself.)

So in November 2009, the plaintiff filed this action alleging the usual breach of fiduciary duty, mismanagement, etc. against the Synovus directors and officers. The thrust of the action involved Synovus' lending relationship with one particular customer. The allegations, all of which were denied by Synovus, alleged that this entire relationship breached the fiduciary duty of the directors, etc.

The question here is, what is the remedy and what is the big deal?

Understanding the significance

First, let me point out this matter was settled with all defendants denying everything. The plaintiff's lawyers received \$900,000 in fees (good for them) and the plaintiff received a \$5,000 award (good for him, I guess).

The question is, what is the impact on what Synovus is supposed to be doing?

From the plaintiff's side, this is all about "good corporate governance," particularly as it relates to the lending function. From the defendant's side, this represents massive interference in the management of the company and a case that was likely settled just to make it go away without a large (relatively speaking) expenditure of cash.

The settlement requires Synovus for the next five years (unless the independent directors change their mind or the CEO indicates it is not a good idea) to alter a number of board and management practices which deal with lending/corporate governance/risks.

For example, the settlement requires Synovus to:



All that is good. In fact, very good.

The lending issue (the facts)

The settlement also has a significant section addressing credit administration, loans, and management related issues

Unfortunately, this particular matter has been a bit misreported in the trade press. Reported in the trade press was basically that the directors were to abdicate their duties as it related to the lending function. That is not the case here at all.

This issue of directors abdicating their responsibility over the lending function is not a new one. In fact, a number of pundits, after the FDIC started filing lawsuits against directors of failed banks (my old job) argued that directors should have nothing whatsoever to do with the lending function.

The implication of the trade press was that the Synovus settlement required the same. Again, that is not the case.

First of all, directors of community banks, or even larger banks like Synovus, cannot simply abdicate their responsibility over the credit function.

Most bank balance sheets (unless the bank is trying to look like an investment bank and have more securities than loans) should have the majority of its assets in loans. The board simply cannot ignore the credit area. The Synovus decision does not require that. It does require that the board should not specifically approve individual loans. That, apparently, was an issue in this case.

In general, for a bank the size of Synovus, that probably makes sense. For most community banks, it probably does not.

For most community banks under \$1 billion, there will still be a loan of a certain size that will go to the board for ultimate approval prior to funding. That is the board exercising its fiduciary duty.

In the Synovus situation, the settlement indicated that the "board and its committee shall not approve loans, but will provide oversight of management's lending and credit policies." Arguably, that is the way it should be in a bank the size of Synovus, particularly when there had been a problem, apparently, with the board approving loans in the past.

#### Understanding the rest of the settlement

The rest of the matters regarding credit and management changes regarding credit all appear to be appropriate corporate governance structures and meet the appropriate exercise of fiduciary duty by the board. In other words, I am not sure the settlement and litigation, other than probably being annoying to Synovus, required them to do anything other than what they should have been doing in the credit area and what any community bank on a smaller scale should be doing as well.

This includes, for example, a risk committee of the board reviewing credit risks for the company, particularly as it relates to large borrowers; an audit committee reviewing troubled credits for the company; from a management standpoint, creating a management level credit risk committee responsible for the lending function and overseeing credit risks for the company; strengthening the credit and underwriting practices by building an independent regional credit structure reporting directly to the chief credit officer; improving the implementation of the enterprise risk management system; and on and on.

Most of the Synovus settlement, while making good headlines for the trade press, really required Synovus to follow appropriate procedures in exercising the directors and senior management's fiduciary duty.

The settlement did not bar the directors from participating in the lending function.

It did prohibit them from approving individual loans, which for a bank the size of Synovus is appropriate.

For most community banks, it is still part of the director's fiduciary duty to take a look at loans over a certain level. That is the distinction.

## About Jeff Gerrish

Jeff Gerrish is chairman of the board of Gerrish McCreary Smith Consultants, LLC, and a member of the based law firm of Gerrish McCreary Smith, PC, Attorneys. He is a frequent contributor to ABA Bank Journal and ABA Bank Directors Briefing, and frequently speaks at ABA events and telephone briefings.

Gerrish's consulting and law firms have assisted over 1,500 community banks in all 50 states across the nation since their formation in 1988. Gerrish formerly served as regional counsel for the Memphis regional office of the FDIC and with the FDIC in Washington, D.C. with nationwide responsibility for litigation against directors of failed banks. Currently, Gerrish's practice involves mergers and acquisitions, strategic planning, capital raising, and general consulting with community financial institutions

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