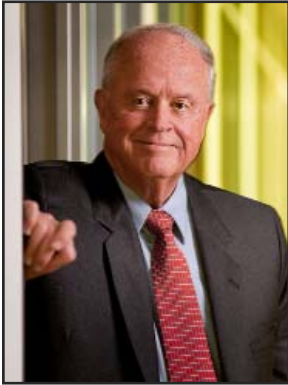


Shrunkened Boards Promise Bigger Headache for CEO

by Paul Davis



Roger Kenny
Vice Chairman, CTPartners

Corporate Governance. "We're entering a new generation of board responsibility, and we're experiencing a significant change in the expectations for what boards do."

Bank boards have been slimming down and the trend will only continue, observers said. Among the nation's biggest banks, the average board has roughly 15 directors, ranging from 10 at Capital One Financial Corp. to twice as many at BB&T Corp., according to company filings. Many boards grew in the last decade as companies made acquisitions or sought out high-profile directors to raise the board's profile.

Ray Groth, co-founder of Duke University's Director's Education Institute, said he expects more boards to dwindle to as few as seven to nine members, consistent with a broader trend across corporate America.

For management, that presents a number of challenges. First, smaller boards tend to be more independent than larger ones because there is less opportunity for friction on sensitive matters, experts say. Second, trimming a board too much may leave management at a competitive disadvantage.

There is a delicate balance for right-sizing bank boards, Davis said. "Anything smaller, and you probably don't have enough eyesight into the global marketplace," he said. "Anything bigger, and the organization becomes unwieldy."

Responding to regulator and investor pressure to be more accountable in a post-crisis world, an increasing number of banking companies are shrinking their boards and asking more of them.

"The writing is on the wall that investors want accountability," said Stephen Davis, the executive director of Yale University's Millstein Center for

Reducing board sizes could address a concern that banking companies may find it harder to encourage people to volunteer in what has become a time-consuming and highly scrutinized role. Though Bank of America Corp., Citigroup Inc., BB&T and Fifth Third Bancorp have all hired directors this year, some believe that the banking industry as a whole is facing difficulties with recruitment.

"Bank board searches aren't easy these days," said Thomas Watkins 3rd, a partner at the recruiting firm Chartwell Partners. "There are a lot of negative incentives to serve."

Diminished interest and the rising costs involved with many directors may also lead to smaller boards, some said.

Government oversight and legal quagmires have threatened to dampen interest. Several governance experts pointed to the New York attorney general's decision in September to subpoena five B of A directors to discuss disclosures concerning Merrill Lynch & Co.

Roger Kenny, the board practice leader at the recruitment firm CTPartners, said the legal summonses can only serve to spook others. "The industry is lucky to still have a group of volunteers willing to do the job, but the pool is shrinking," he said.

Such actions are driving up the cost of insuring any individual director from liability, something that is considered a necessity to get qualified candidates to serve. Depending on the type of coverage, premiums have been rising 10%-20% this year after jumping at least that much in 2008. Banking companies also face stricter terms and conditions, lower coverage limits and higher deductibles.

"And there are claims for things such as fraud that are not" covered, said Finley Harckham, a lawyer at Anderson Kill & Olick.

That may require bigger paychecks for those who serve, Davis said, an incentive to downsize the board. "Their responsibilities

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are growing beyond compliance," he said. "The job now includes strategy and oversight. So there is an argument gaining ground that nonexecutive directors need more compensation for what they are doing."

As boards get smaller, their makeup is likely to age, observers said. Added duties are likely to increase time commitment, which could rule out those who are executives at other companies. The result may be an aging candidate pool of retirees who are available to serve. The average age on the biggest banks' boards is already 61, leaving less than 10 years until they reach the typical board retirement age.

"Active professionals often cannot make the time commitment necessary to be an effective board member," Groth said.

Board independence has been steadily rising in the past decade. Eighty-eight percent of directors at the 12 largest banking companies are independent. Five years ago and immediately after passage of the Sarbanes-Oxley Act, independent directors made up about 84% of the board at those companies.

Before the law was enacted, independent directors likely held about two-thirds of board seats of public companies, though the percentage tended to be a little higher at banks, Groth said.

Still, the composition of boards is likely to change, with fewer "celebrity" directors and more independent thinkers. B of A replaced retired Gen. Tommy Franks earlier this year in a shake-up that reduced the size of the board by three seats, to 15, and brought on new directors with considerable banking expertise. That could usher in more directors who are unwilling to go along with the CEO's agenda, though at most big banks that executive is still the chairman, some said.

"Boards are more willing to question and challenge the direction of management," Groth said. "Where corporate performance or strategic direction is not what the board wants, directors are going to be more willing to replace the CEO."