

ITALIAN BOARD STYLE

by [Steve Brown](#)

The Italians call it "sprezzatura" and it is the style of pulling off superior performance without the outward appearance of effort. When applied to corporate boards in Italy, it is a high compliment and it means you are performing at the top of your industry in an understated and stylish manner. Sprezzatura does not come easy for boards, but rather, is learned from years of working together. As we go through strategic planning sessions, one common theme that keeps coming up is that some community banks underutilize their board and may lack sprezzatura.

In our opinion, it is every board's responsibility to provide oversight, strategy and execution assurance, in that order. Boards, like any other human capital at the bank, are a resource that needs to be maximized. We are continually surprised by the high quality of the average community bank board and nearly as surprised that management does not want to ask directors for too much input for fear of putting them out. Ironically, many board members feel that are in fact underutilized and would like to offer a larger contribution to the organization, beyond just bringing in business. In the grand scheme of things, the business that a board can bring pales in comparison to the amount of franchise value quality boards can impart on a bank.

Part of managing a board is to set expectations and evaluate accordingly. Board members need feedback, just like everyone else. Sarbanes-Oxley requires large banks to evaluate their board of directors, yet few smaller banks engage in this process. We recommend that every board be evaluated 1x per year. Before this occurs, the board and management must set the evaluation criteria and expectations. This criterion should be clear, concise and measurable. Overall bank performance plays a part here, because if the board isn't managing the basics, they may not be up to the task. Items like EPS growth, asset quality, CAMELS/exam issues, capital ratios and risk measures; should all play a part. Meeting participation should also be measured, as well as the completion of assigned tasks. The quality of discourse should also be reviewed. Finally, a board that generates value will constantly be evaluating the market, in order to bring up new ideas and strategic direction to the institution.

Another trait of quality boards are members that are not afraid to question management on their strategy or assumptions. The quality questioning of management, in our opinion, is one of the most valuable traits that a board can impart. For that matter, a well functioning board is comfortable in dealing with difficult issues. Succession planning, underperforming executives, a board member that rarely gives input, cronyism, slipping service standards, profitability issues and many other topics should all be handled with ease and aplomb. Anytime there is a topic that is off limits, a dysfunctional board is usually at work. Determining the quality of input may be difficult to measure, but utilizing a 360 degree review where all board members are confidentially evaluated by each other (as well as management), may be instructive. If a 360 degree review isn't workable, then bringing in a consultant to conduct interviews and observe a meeting may be appropriate. When the results are compiled, the annual offsite retreat is an excellent way to deliver the report card.

As with any evaluation process, having the confidence to put egos aside for the sake of bank improvement is a hallmark of a quality board. Once the evaluation process is complete, boards must take steps to improve. Evaluations should identify problems and an action plan can be put in place to

correct deficiencies. Sometimes the solution is to restructure committees or even replace board members that just aren't up to the task. More often than not, however, the solution is education and training. In fact, in 2011, more than 80% of the boards we surveyed believed they could use increased education, particularly when it came to credit quality management and regulatory issues.

Optimally, a board works as a cohesive team, with each member contributing both work effort and intellectual prowess. By instituting a valuation process, setting expectations and correcting problems, a high functioning board can add tremendous shareholder value. As they say about Italian corporate board governance, *L'occhio del padrone ingrassa il cavallo* - a business thrives under the eyes of its owners.

BANK NEWS

Strong M&A

First Financial (\$2.5B, IN) will buy Freestar Bank (\$402mm, IL) for \$47mm, or 1.66x tangible book. The move gives First Financial 13 branches and expands its footprint in IL. Freestar specializes in agriculture, single family and business lending and has a very low ratio of nonperforming assets, an ROA of 1.34%; ROE of 12.78% and NIM of 4.39%.

Volker Rule

Banking regulators have requested public comment on a 298 page proposal of Dodd-Frank restrictions that ban banks from making short-term trades for their accounts or owning hedge and private equity funds. Comments are sought through Jan 13, 2012.

Banking Returns

Experts say Wall Street firms and large banks will likely see ROE fall by as much as 6 percentage points in the coming years, as regulation bites into profits. New rules from the Basel Committee have doubled capital requirements, fixed income revenues are expected to fall 25% and leverage has been cut by 50% at large Wall Street firms.

Housing Floor Is Near

Mark Zandi, the chief economist at Moody's, said home price equilibrium is in sight and problems in the sector are manageable. He predicted the housing market would stabilize after another year or two.

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