Does Your Board Have Skin In The Game?

by Steve Brown Topics: board of directors, strategic planning

Summary: Conventional wisdom is that having directors with a financial interest in the bank can be beneficial. We examine the pros and cons.

The top five favorite types of cheese in the US in order are cheddar, mozzarella, american, pepper jack and provolone. We know that this is kind of a cheesy way to open today, but we hope you had fun with it, nonetheless.

Melted cheese can be sticky and the Fed has produced a guide to help banks improve the stickiness of recruiting and retaining community bank board members. It has listed 24 attributes that make an "ideal" director that includes such things as: financial and business acumen, independent thinking, and connections with community businesses and industries. Missing from the list: the need for directors to have a financial stake in the bank.

While the Fed may not have much to say about bank directors and how much they should own in a given bank, there is plenty of interest in the subject among community banks and bank advisors. Conventional wisdom is that having directors with a financial interest in the bank can be beneficial. It helps ensure that the interest of the board member and the bank are in sync. If the board member has a financial interest in the bank, the logic goes, then that board member is more likely to look out for the financial interest of the bank too. Others may disagree though, seeing a potential conflict of interest, when directors own considerable stakes in the bank.

A number of recent discussions have touched on the idea of director ownership, with many coming down on the side of favoring a financial interest. One consultant who favors investments by directors went so far as to try to quantify how much a director should own. They concluded that every director should have at least $25,000 invested. But, we wondered what that meant to a bank the size of Bank of America for instance vs. a community bank. Along those lines, this consultant said they had seen instances where the required investment by a director was as high as $250,000. Whatever the amount, if this is what your bank chooses to do, it is important that directors have enough at stake to be meaningful.

If share ownership by directors is required, the bank needs to provide a methodology that is not overly taxing on a prospective board member. The bank might have a time frame by which a director would need to acquire shares - say up to 5Ys for instance. The bank might also offer shares in the bank as part of, or in lieu of, the fee paid for serving on the board.

Of course, a downside to required ownership is that it could work as a disincentive to prospective board members who might otherwise be good candidates. They may have their money tied up elsewhere, don't want to own shares or, in some cases, can't spare the cost. That can pose a dilemma to community banks who seek experienced and high quality directors. So this is a fine line to walk, and very locally specific too, we might add.

The bottom line is that while having directors invest their money into the bank may seem desirable, it should not overshadow other basic criteria and the balanced needs of the board. For more information on balanced boards, you can read our BID, Do You Have a Balanced Board?

BANK NEWS

Scary Thought

The Bank of Japan is reportedly becoming more open to reducing short term rates and pushing them even further into negative territory, as it responds to ongoing economic softness. If it does so, it will try to keep the longer end of the yield curve higher in order to preserve some sort of upward slope for banks, insurance companies and pension funds to survive.

Interest Rates

In a recent NREI survey of CRE professionals, 25% believe the Fed will lower rates 2x in the next 12 months; 32% believe the Fed will lower rates only once; 15% believe the Fed will increase rates once in the next 12 months; 14% do not expect any changes from the Fed.

Credit Cards

A Northwestern Mutual survey of US adults finds 31% pay interest rates on credit cards greater than 15%, but another 19% say they don't know what their interest rate is. In addition, about 12% of people say they only pay the minimum amount due each month.

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