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THE DIRECTOR'S JOB

ADVISORY BOARDS AND OTHER MECHANISMS CAN HELP GIVE POTENTIAL BOARD MEMBERS A TRY-OUT

A car may look great in a commercial, but you wouldn't actually buy it without at least a test drive. Yet some institutions bring new directors or trustees onto the board without the equivalent. And while a candidate might be a great customer, local leader, or diligent business owner,

none of those necessarily imply great directorship ability. As you know, directorship is hard work—and getting harder and more time-demanding.

During ABA's recent National Conference for Community Bankers, *ABA BDB* sponsored a director peer group discussion moderated by **Jeff Gerrish** of Gerrish McCreary Smith, PC, and **Robert Todd**, chairman of Bridgewater Savings, Raynham, Mass. We're working on bringing you a transcript of the event. But in the meantime, we thought you'd find it interesting to sample the discussion about advisory boards that occurred at the free-ranging meeting.

RECRUITING FROM ADVISOR RANKS

Bob Todd got things going by explaining how his organization, as a mutual bank,

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DEAR DIRECTOR:

Bankers Butt Heads With FDIC's Bair After She Scolds At ABA Government Relations Meeting

Bankers can sometimes be courteous to a fault, with legislators and regulators. But this time they were having none of it.

After a formal speech in which FDIC Chairman Sheila Bair took the banking industry to task for some of its attitudes and recent history, bankers rose during a Q&A session with her at ABA's Government Relations Summit, March 14-16, and gave Bair a piece of their minds.

Hold on there!

Nearly 1,000 bankers in attendance had had several days of discussion and visits with regulators and trips to Capitol Hill. FDIC's unpopular guidance on automated overdraft checking programs (Financial Institution Letter 81-2010) and the Dodd-Frank Act in general became lightning rods for a general level of frustration.

• *Vermont banker:* "We are not writing the checks" that cause overdrafts, said one banker. "Our *customers* are making the decision to write the checks. This is systemic in our society. We are weak on responsibility for our actions."

This same banker—having heard Bair speak of Dodd-Frank as almost a benefit to community banks because of its impact on very large institutions—continued to express frustration. No bank in his state took TARP money, he said, and foreclosures were quite low there.

"We don't need more regulations," the banker continued. "We try to do the right thing day in, day out. The only thing that new regulations are doing is increasing our costs."

"I encourage you to think for yourselves and don't be based on hypothetical things that could happen. Look at what's really happening."—FDIC's Sheila Bair regarding community banker opposition to the Dodd-Frank Act's regulations.

• *Michigan banker:* Having heard in another venue that Bair believes that banks' automated overdraft programs cost consumers more than payday lenders—and Bair confirmed this belief to the audience, citing FDIC research—this banker grew angry with the chairman.

There's no difference between the charge for covering a check with overdraft service and the charge for a bounced check returned for insufficient funds at his bank. Further, he said, a bank that covers the consumer's check not only saves the consumer from the retailer's bad-check fee, but also keeps them from winding up on the retailer's "hot list."

Bair indicated that she appreciated that point. But she added this: "It would be much lower cost if you set up a line of credit

BY THE EDITORS OF ABA BANKING JOURNAL

ABA industry image toolbox debuts April 4

ABA Chairman Steve Wilson last fall called on the industry to step up and show off its attributes. Since then the association introduced its "Proud to be a Banker" program.

At ABA's March 14-16 Government Relations Summit the association previewed the April 4 unveiling of its industry image toolbox, designed for banks to use locally. More details to be announced on *www.aba.com*

for them. But you [the industry] don't want to do that." Over the years bankers have indicated that many overdraft users wouldn't qualify for lines of credit. Bair's agency has pushed for banks to make small-dollar loans, as well.

This same banker accused FDIC of, effectively, legislating in its overdraft guidance, rather than solely regulating. While he said that the industry appreciates guidance, he added that "guidance" and "guidelines" generally come to be regarded by examiners as formal rules.

"I urge *caution*," he insisted. "Don't overstep the bounds and *don't legislate* when you give guidance. Let the legislative process handle changes in law."

• ***Another banker, with a sense of wry humor:*** This banker said he had taken FDIC advice to heart for some time, and that his bank attempts to counsel those who overdraw too frequently. He gave what he called a representative example, a woman who repeatedly overdrew her account. The bank talked to her and set up a $1,000 overdraft line. Now, the woman overdraws not only her account, but the line, too.

The banker said he was reminded of Larry the Cable Guy, and expressed this thought: "I've got a horse with a broken leg. I'm told I'm supposed to shoot it. Now it's got a broken leg *and* a gunshot wound."

"It sounds like you've done all you could," said Bair. Her beef is with those who will not talk to habitual check bouncers.

"Down with Dodd-Frank"

At several points the possibility—quite remote in any total sense—of repealing Dodd-Frank came up. When Bair asked if the audience would like the law repealed, they made it clear they would. When much of the audience identified itself as community bankers, Bair expressed disbelief.

Much of Dodd-Frank was aimed at large banks, she insisted. "They're really facing the brunt of this and community banks are not," she said. "I don't get that reasoning."

The bankers' collective disconnect to Bair's reasoning was expressed as much in moans and groans during her talk as by the executives who stood to formally comment or question.

When at one point Bair suggested that the new Consumer Financial Protection Bureau would help community banks, loud grumbles of disbelief went through the crowded listeners.

In one of her final comments, Bair stated, "My tenure at FDIC has not shown me to be an enemy to community banks. It shows the opposite." Bair is among those officials who have come out against the Dodd-Frank "Durbin Amendment," which could hurt banks through loss of interchange income.(See the special report in this issue.)

Then she added: "I encourage you to think for yourselves and don't be based on hypothetical things that could happen. Look at what's really happening."

Bair's speech to summit

Bair's formal remarks, frequently pointed, contained this statement early on:

"I would like to propose to you a radical-sounding notion. And it is that increasing the size and profitability of the financial services industry is not—and should not be—the main goal of our national economic policy."

While banks play an essential role in economic growth, she said, the financial crisis was pre-

Hard words from FDIC's Sheila Bair

Sheila Bair has been a tough regulator and not one to mince words. The speech covered in the main article was no exception. If anything—she noted that with her June retirement approaching it might be her last speech to an ABA group—she was extremely direct. Some samples:

• ***Bank earnings:*** "There is great pressure to restore earnings to pre-crisis levels. As we saw in the years leading up to the crisis, there is always the temptation to try to squeeze out a few more basis points in earnings now by watering down certain regulatory provisions that are designed to preserve the long-term stability of our financial system and the deposit insurance fund."

• ***Regulation:*** "We need to get past rhetoric that implies that, when it comes to financial services, the best regulation is always *less* regulation."

• ***Dodd-Frank:*** "I would very much like to hear from the industry a constructive regulatory agenda that would use the provisions of Dodd-Frank to fix the problems that led to the crisis and help to protect consumers and preserve financial stability in the years ahead."

• ***Industry image:*** "The banking industry seems to have an even bigger image problem in the wake of the financial crisis. ... As this historical era unfolds, public opinion as to the role played by the banking industry seems unlikely to be neutral." Bair said banks could choose to be seen as supportive of recovery or "as a group that mainly looked out for its own short-term interests."

ceded by record earnings in banking in the first six year of the last decade. The recession that came next cost the economy 8.5 million jobs, she said, and has seen more than 9 million home mortgages enter foreclosure over four years.

Bair believes the only yardstick that really counts is the performance of the economy. Speaking both for banks and regulators, she said, "let's be completely honest—in the period that led up to the financial crisis we did not get the job done."

Bair pointed to construction and development real estate loans as an example of what went wrong. She stated that net charge-offs of such loans now exceeds 10% of the "C&D" loans that were on bank books at the end of 2007.

"There are some who continue to point to over-zealous regulators as the reason for rising charge-offs and declining balances in C&D portfolios," said Bair. "But the truth is that small and mid-sized institutions held record-high concentrations of these loans when U.S. real estate markets began their historic slide in 2006 and 2007. Regulators have done what they can in the wake of the crisis to facilitate loan workouts that help borrowers and banks while conforming to accepted accounting principles. But we cannot make the problem go away overnight."

Many bankers in the last two years have complained that examiners and real estate appraisers have played off each other, with falling appraisals driving writedowns forced by examiners who tell bankers to act immediately, rather than waiting for properties to make a comeback.

Faulting industry resistance

Bair indicated a belief that results might have been less severe had regulators reined in more of this lending when it was happening.

"But a review of comment letters

DEAR DIRECTOR *continues on p. 4*

benefited from having "corporators." This group of local folks' main mission is electing the officers and directors of the bank. But, Todd explained, "they also act as the eyes and ears of the bank, and give us reactions that they're getting from the public."

These roles represent key functions, of course, but the corporators are regarded as well as a sort of "farm team" from which future directors can be drawn. Todd said this is especially important right now as Bridgewater Savings has some board retirements coming up. Corporators are expected to attend two out of the three board training sessions offered annually.

Audience volunteers spoke of their own efforts using advisory boards and advisory director positions as a means of accomplishing the same end.

One Texas banker said his practice, when a director is expected to retire or need to be replaced, has been to appoint an advisory director.

"Quite honestly we feel like that's the fair thing to do," he said. "Directors have liabilities, and it's unfair to ask somebody to assume the liabilities that a director has until they have a chance to get educated, to understand what's going on in the bank." So the bank gives the director-candidate advisors in for a year. They sit in on board meetings, with no vote.

"If they work out for us, and they feel they want to go for it," says the banker, "then we recommend them at our annual shareholders meeting."

Gerrish asked if the banker had ever had one not work out. "Yes," the banker answered, "and it is easier to get rid of an advisory director than it is to get rid of a full director."

Another, larger bank that is publicly traded maintains an official advisory board. "The members are our best customers, people who are centers of influence, and they are our ambassadors out in the community," said a member of the bank's board. Nine advisors serve from each of six school districts in the bank's markets. All 54 meet once a year, and there are additional local meetings. "We see them as potential directors because we discuss our results with them," said the board member. They also take part in the bank's annual economic forum. The bank emails them financial updates and also taps their opinions of new services.

ADVICE ON ADVISORS

Gerrish, an experienced board advisor, said most advisory boards serve some combination of marketing or training/recruitment purposes.

"No matter how you use them, put term limits on them, because you don't want to put people on and then have to *take* them off," said Gerrish. "Compensate them in some fashion for their time."

Finally, he advised, make the advisory boards part of someone's job description at the bank.

"Somebody needs to be responsible for nurturing that advisory board," said Gerrish, "or it is going to get lost in the shuffle."

Audience members questioned the practice of some banks of inviting advisory board members or advisory directors to attend official board meetings. Confidentiality was a concern.

Gerrish said this had come up with clients. One has regional advisory boards that vote on local loans. He said this makes them "institution-affiliated parties," and thus they have some exposure. Further, he said regulators required signed confidentiality agreements to continue seeing customer information.

The Chairman's Job

ABABJ.com blogger Jeff Gerrish has recently posted a companion to his popular "The New Ten Commandments for Bank Directors." It is "The Ten Commandments for Community Bank Chairmen," at *www.ababj.com/blog/1896.html*

FDIC: 2010 marked turnaround year for industry

Things are beginning to come back for the banking industry, FDIC reported in late February in the agency's *Quarterly Banking Profile*.

"Overall, 2010 was a turnaround year with four straight quarters of positive earnings," stated Chairman Sheila Bair in a press conference. "While earnings in 2010 remained well below pre-crisis levels, the past year marked a significant milestone on the road to recovery. We are encouraged not only by the rising trend in total industry net income but also by the fact that a substantial majority of insured institutions are participating in this trend."

Bair added that while community bank return on average assets lagged that for larger institutions, as a group the smaller banks are recovering. They reported higher earnings than in 2009.

Some comparative numbers for full-year ROA:

- Industrywide, ROA came in at 0.66% for 2010, versus –0.08% for 2009.
- For banks and savings institutions under $100 million, ROA came to 0.33%, versus –0.05%.
- For institutions between $100 million and $1 billion, ROA also came to 0.33%, versus –0.10%.
- For institutions between $1 billion and $10 billion, ROA came to 0.24% versus –0.35%.

More than two out of three banks, overall, reported an increase in earnings for 2010. And the portion of the industry that was unprofitable fell substantially, year over year. In 2010, 21% of institutions reported losses, while in 2009, 30.6% did so. FDIC noted that this was the first time in six years that the portion of the industry that was unprofitable for the year declined.

Overall, FDIC indicated, it is improving credit performance, leading to lower loss provisions, that has contributed most to earnings growth.

However, Bair observed that only so much can be accomplished through lower provisioning for losses. She noted that through the crisis revenues were "resilient," but with little upward movement.

"A key reason why revenues have not grown faster is that loans have not been growing," said Bair. "About two-thirds of the industry's net operating revenue comes from net interest income, which in turn comes primarily from making loans."

ABA's Chief Economist, Jim Chessen observed that FDIC's numbers demonstrate that "the banking industry is indeed regaining its footing. Asset quality has improved, loan losses have declined, and banks continue to increase their capital levels. This has helped solidify the base for making new loans to bolster growth in the expanding economy."

Indicators in FDIC report

Some trends to watch:

- *Service charges.* Deposit-related service charges fell by 13.1% in 2010—the first time in 69 years that that figure has fallen. That measure fell by 20.7% in the fourth quarter versus the same 2009 period.
- *Loan balances.* Continuing Bair's theme of the need for loan growth, FDIC noted that loan balances fell at nearly six out of ten institutions in the fourth quarter. Real estate construction and development loans fell the most, dropping by 9.2%.
- *"Problem list."* The institutions on FDIC's problem list rose to 884, from 860—meaning that 11.5% of the industry is on the list.

DEAR DIRECTOR (CONT'D.)

sent to regulators by industry trade associations before the crisis shows a consistent pattern of opposition," she said. It was pointed out, for instance, that "high levels of commercial real estate lending were necessary in order for small and midsized institutions to effectively compete against larger institutions."

On the mortgage side, she said, "when we issued proposed guidance on non-traditional mortgages, industry comments found the guidance too proscriptive."

Bair's diagnosis, overall:

"For our part, I think it is clear in hindsight that while our guidance was a step in the right direction, in the end it was too little, too late. To be sure, most—but not all—of the high-risk mortgage lending was originated outside of insured banking institutions. But many large banks funded non-bank originators without appropriate oversight or controls. And CRE lending did not cause the crisis, though poor management of CRE concentrations made far too many institutions vulnerable to the housing market correction some opportunities before the crisis to help protect well-run institutions from the high-fliers—both within and outside the banking industry—whose risky lending practices were paving the way for the real estate crisis."

Sincerely,

Steve Cocheo

for *ABA Banking Journal*

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