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Mutual Stock Issuances Surge Amid Changing Environment

Mutual institutions, in a quest for flexibility and capital, are tapping equity markets in growing numbers. The number of conversion transactions announced in the first quarter of 2021 has already ticked past the total for all of 2021.

By mid-March, 11 mutual holding company minority stock issuances, second-step conversions, and mutual-to-stock conversions were pending, and two had been completed, according to the law firm Luse Gorman, which is counsel in nine of the transactions.

Kip Weissman, a partner at the law firm, noted that the trend is nationwide and involves institutions ranging in size from $250 million to $2 billion in assets. Transactions are under way in Alabama, Georgia, Louisiana, New Jersey, New York, Pennsylvania, Texas and Wisconsin.

The trend is being driven by a mixture of both uncertainty and opportunity in the banking industry as well as the rising stock market, Weissman said.

"Capital and flexibility are king when then there is uncertainty over the economy, regulation and technology," Weissman said. "And with the stock market at record levels, banks can be confident they can get their transactions done."

Right now, economic and market conditions are relatively stable and the loan portfolios of banks are emerging from the pandemic with fewer negative effects than initially expected. Also, the mergers and acquisition market is heating up, and some very bullish outlooks on the economy have emerged. Notably, in mid-March Goldman Sachs raised its GDP growth expectations for the U.S. economy to 8 percent for 2021, which would be a massive expansion.

All of this translates into a brisk market appetite for deals. Raising capital when the stock market is strong is a time-honored strategy for mutual banks.

Some mutuals are interested in deploying capital to upgrade technology, which "advanced 10 years in a year" thanks to the COVID-19 shutdown, Weissman said. The ripple effects of the pandemic forced financial institutions to accelerate both remote communications capabilities and mobile delivery of services. Additionally, "adopting a MHC or stock structure would provide the tools to attract key personnel to enhance competitiveness."

In this environment, it's prudent for directors to make sure banks know their options, Weissman said. "If I were a director, I'd want to have management prepare alternatives for me so I can look at them side by side. I would want to see a comprehensive base case projection of the future over the next three years, and then I would want to model different opportunities, one of which would be selling stock."

FOCUS ON COMMITTEES

Remote Work's Ripples Impacting Audit Agenda

Audit committees have a big job on their hands as they grapple with understanding and measuring the risks banks are taking because of their dispersed workforces, according to Sal Inserra, financial services audit partner at Crowe.

Banks are still working through the implication of the massive shift to work-at-home arrangements that occurred as the COVID-19 pandemic struck in March 2020. And the issues

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In This Issue

Study: Women Bring Unique Perspectives to Leadership

Women in leadership bring experiences and perspectives that can help banks innovate more and improve their financial performance, according to a report by Alloy Labs Alliance.

Alloy Labs, an ABA strategic partner, is an innovation consortium formed by community and midsize banks. Amber Buker, director of insights at Alloy Labs, cited three factors that help women innovate: their diverse career paths, their life experiences, and the need to rely on transformational leadership to fight bias.

Women's diverse career paths, life experiences, and reliance on transformational leadership to fight bias equip them for success.

As banks intensify their focus on diversity, equity and inclusion, there is ample research to support that advancing women yields benefits, Buker said. "It's intuitive that the more diverse viewpoints you have, the more and better ideas you're going to get," she said while presenting the report findings during a recent ABA webinar.

Joining her on the webinar, "Enhancing Performance through Diversity and Innovation," were Naomi Mercer, ABA's senior vice president of diversity, equity, and inclusion, and Stacey Bentley, CEO, Community Bank and trust, Waterloo, Iowa, part of $2 billion-asset Cedar Rapids Bank and Trust Co.

Among their key observations:

Women tend to have a more diverse path to the C-suite. Many of them rise through the CFO and COO positions. "They are able to break the mold of the typical CEO who rises through lending success," Buker said. Mercer added that performance in these roles is "highly quantifiable," arming women with the hard data to show they're good at their jobs.

Women are more likely to have life experiences that equip them to lead through innovation. Bentley said the challenges of juggling family responsibilities with work obligations tends to make women nimble.

Women may take a transformational approach to leadership to combat bias. This means emphasizing the good of the group over individual self-interest; working to build trust and be seen as role models; and innovating even when the organization is successful.

Research finds significant correlations between women in leadership and financial performance, Buker added. She cited a multiyear study by McKinsey that showed that companies in the top tier for gender diversity are 25 percent more likely to experience above average profitability than non-diverse companies. The figure has risen steadily from 15 percent in 2014.

"Not only is there an opportunity there to grow your profitability by having women in leadership but that opportunity is getting bigger and bigger," Buker said. By the same token, "If you're behind in diversity, the gap is going to grow," she said.

Companies with above-average diversity also saw innovation revenue that accounted for 45 percent of total revenue, Buker added, citing a Boston Consulting Group study. Innovation revenue is defined as coming from new products and services launched in the past three years.

"Diversity is a return-driver for banks," Mercer said, pointing to a Federal Reserve study. "When a bank board is between 13 and 17 percent women, that's the tipping point that drives the bank to perform better, and they have higher regulatory compliance."

Bentley noted that while commercial lending is traditional path to the C-suite for men, that's less true of women. She started out in bookkeeping, then moved into wealth and trust services before becoming a commercial lender. Along the way, she amassed varied skills that have served her well as CEO, because she understands everything from how to read a blueprint to how to service an ATM.

DIRECTORS BRIEFING

Larry Price Publisher
Debra Cope Editor-in-Chief

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Spotlight: Virginia's Chesapeake Bank Taps Organization for Help in Diversifying Board

Jeff Szyperski, chairman, president, and CEO of Chesapeake Bank, is proud of leading an engaged, stable board of directors, half of whom have served at least 15 years. The entire director slate comes up for election annually to provide strong accountability to shareholders.

But one thing his board was lacking was women's voices. "We weren't stale, but we were definitely pale and male," Szyperski said, riffing on a popular cliché about corporate directors. "We were conscious of the need to add more diversity."

On April 2, shareholders of $1.2 billion-asset Chesapeake Financial Shares Inc., the bank's parent, elected two women, Susan Quinn and Dee Ann Remo, to new board seats. The new directors bring fresh skills in corporate branding and wealth management, respectively. They also helped nudge down the average age on an 11-person board that ranges from 50 to 87.

Szyperski said he had been thinking for five or six years about board diversity, "because we felt it was the right thing to do." In the past two years, industry dialogue around diversity has intensified, and "people are falling over themselves to get where we need to be," Szyperski said. "Fortunately, we were having these discussions before the pot really started boiling."

At the ABA Conference for Community Bankers in February 2020, he heard a talk by Terrie Spiro, a co-founder of Bank on Women, non-profit that helps community banks add qualified women in leadership roles.

"I remember Terrie saying, if you want something different, you need to try a different method of garnering prospects." Syzperski recalls leaving the meeting energized about recruitment. Then COVID-19 hit, and suddenly Chesapeake Bank—like every other bank in the U.S.—had new, pressing priorities. It was the summer of 2020 before he could call Spiro to enlist her help.

Spiro is a well-known community bank CEO with a track record in turnarounds. So when she came before the bank's governance and compensation committee, "they had a lot of comfort in her recommendations. She also presented the financial rationale for diversifying, and that was very helpful."

CEO says Bank on Women helped to identify three 'hugely qualified' director candidates.

Spiro got busy—first by listening to the bank's needs, and then by combing through the Bank on Women database and casting a wide net to identify female candidates. She soon narrowed it to three.

"All three were hugely qualified and understood the mission of community banking," Szyperski said. "Two were in our trade area and the third was close." After interviewing all three, he advised the governance and compensation committee to consider all of them. In the end, the bank chose the two who were local, regarding it as a solid start.

Szyperski believes board diversity sends a positive message to employees. "Female employees and minorities are looking for representation all the way up the ladder." He regards the initial hires as "a baby step," noting that racial and ethnic diversity also have to be considered.

3 Three Questions for…

Terrie Spiro
Founder, Bank on Women, Inc.

Is one female director ever enough?

You have to stay away from having a token female director. Research shows that you need one-third diverse members to start deriving the benefits of board diversity. As you approach that level, you'll start to see cognitive diversity in decision-making, including better performance at the bottom line.

What's the quickest way to add women?

If directors don't exit naturally through age restrictions, the quickest way to diversify is to expand the board. Board members tend to enjoy a lot of camaraderie. They don't want to retire or be moved off.

What strategies help with diversifying?

Start with an assessment that takes stock of what skills are needed on the board, and have a strategic plan for developing the board. Push beyond traditional channels for referrals because men and women often don't travel in the same circles.

Independent Boards Not Just for Public Companies

Private companies need independent boards every bit as much as public companies do, according to G. Bradford Bulkley, founder and CEO of Bulkley Capital, which assists middle-market and privately held companies with M&A and capital raising.

"Companies that exercise strong corporate governance through organized, independent boards with well-defined responsibilities and real authority exhibit the best long-term financial performance," Bulkley wrote in an article published by the National Association of Corporate Directors.

Private company owners may be reluctant to cede power to a board for fear of losing control. But a properly structured private company board, developed by ownership with an outside lead director's input, "should assuage most fears," he wrote.

"In too many cases, when private company owners or CEOs take the initiative to form a board, they surround themselves with golf buddies, old college pals, and others who tend to look and sound just like they do," Bulkley wrote. However, "A good board is not there to answer management's questions, but instead to question management's answers."

CEO is a vital board responsibility, and independent boards can help by providing an honest, unbiased viewpoint in assessing the talents of potential successors, Bulkley wrote. Independent boards should also assess the entity's management, legal and tax structures; understand and evaluate risks; measure progress against industry benchmarks; and advise on annual plans and M&A opportunities.

He stressed the importance of documenting the lead director's responsibilities. These generally include determining what skill sets the board requires, recruiting other members based on a qualification matrix, conducting annual board evaluations, and setting board meeting agendas with the CEO.

COMMITTEE FOCUS

(Continued from page 1.)

raised were different from the bread-and-butter topics that typically come before the audit committee, such as accounting and financial reporting.

"Whatever the audit committee thought they were doing as of February 2020 had to be shelved, and they were forced to play real-time catch up with changes in operations," Inserra said in an interview. "They've had to take a crash course in information technology-level control issues."

Inserra noted that for many banks—including most under $1 billion—the audit committee's responsibilities include risk. Above $3 billion, it's common for banks to have separate audit committees. In between $1 billion and $3 billion, practices vary.

The challenge is that "audit is primarily responsible for looking in rear view mirror and determining at the application of controls was done correctly. Risk's job is to figure out where the bank is going and whether the right controls are in place."

'We don't know whether this stopgap process of allowing remote work will get banks where they want to go strategically.'

It's important for audit committees to get management's thoughts on what the workforce will look like—and how much of it will operate remotely. "People like working in their pajamas, and as long as it works, banks may allow that," Inserra said. "But we don't really know if it works. We just know it didn't fall apart. And we don't know whether this stopgap process of allowing remote work will get banks where they want to go strategically."

Audit committees' job is not to dictate to management whether they will have a dispersed workforce, Inserra said. Rather, they have to measure the risk management is willing to accept, assess how it is managed, and then provide oversight.

"As audit committee members work through this process, they have to look in the mirror and decide if they're the right people for this job," Inserra said.

Inserra tells audit committee members that they need to freshen up the questions they are asking. "The old questions may no longer be relevant," he said. "When we are doing audit, we start off with the concept of 'what can go wrong?' Audit committee members have to challenge themselves with the same question. You can't assume you're smart enough to see the future."

After making it through the storm, it may seem appropriate to sit back and relax. But instead Inserra urges audit committee members to focus on change while the fear of the storm is still fresh on their minds.

Social Crosswinds and SEC Disclosure Rule May Nudge Boards toward a More Sustained Focus on Human Capital

Boards can follow five practical steps to make human capital management a strategic business advantage without overstepping the role of management, two Conference Board executives said.

Boards traditionally provide general oversight and become deeply engaged in workforce issues only when circumstances warrants, the executives said in a recent article. But recent developments, including the COVID-19 crisis and a growing calls for social justice, are prompting boards to consider whether they need a sustained strategic focus on the workforce.

The authors— Paul Washington, executive director of the Conference Board ESG Center, and Rebecca Ray, executive vice president for human capital at The Conference Board—said their recommendations on creating long-term value through human capital management and disclosure flow from a report from a working group involving 100 practitioners and thought leaders.

They noted that the Securities and Exchange Commission last year adopted human capital management disclosure rules that require companies to describe their human capital resources, and any human capital measures or objectives that are a focus of managing the business. This action gives resonance to the common phrase that "people are our most valuable assets."

These are the authors' five suggestions for boards, excerpted from "Directors and Boards":

Develop a human capital strategy linked to business strategy. A strategy might address developing the workforce the company needs in, say, five years. It would identify key areas where the workforce drives business success; evaluate current capabilities in key areas; assess the broader trends and competitive environment for talent; and set clear goals and choose metrics to report progress.

> **Increasingly, companies may face demands to quantify the concept that 'people are our most valuable assets.'**

Clarify, codify and coordinate board roles. Work with management to clearly define the board's role with respect to human capital management. Start by gaining directors' consensus on how much value they can add by engaging in this regard. "There is no single right answer, but it is critical to be clear," the authors said.

Confirm that the board has the information it needs to fulfill its role. Work with management to determine what human resources data matters and how to best present it to the board. Boards should request qualitative and quantitative information.

Ensure that boards have the correct composition and resources. When evaluating a board's makeup, consider adding human capital management expertise.

Double down on the company's human capital management story to ensure it is communicated consistently and effectively. Ensure that management has determined which messages are aligned with the firm's corporate strategy, and communicated them consistently across different audiences.

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Survey: As Work Moves Home, Cybersecurity Tops Bank Risks

Cybersecurity and credit topped the list of risk categories that concerned banks at the start of this year, according to the 2021 Risk Survey published by "Bank Director."

The annual survey found that 92 percent of participants said cybersecurity risk increased, either significantly (49 percent) or somewhat (43 percent).

One in six respondents (17 percent) said they saw a need for more focus on cybersecurity by the board. This observation was most pronounced among banks with assets under $500 million, with 25 percent identifying a need for more board attention.

Credit was a close second in terms of overall risk concern, with 89 percent saying risk increased. However, the severity of concern appeared to be lower. These respondents were less likely to say risk rose significantly (27 percent) and more likely to say it rose somewhat (62 percent).

Strategic risk was in third place, with 62 percent of participants seeing either a significant increase (9 percent) or somewhat of an increase in risk (53 percent.) Interest rate risk followed at 57 percent, with 17 percent noting a significant increase and 40 percent noting somewhat of an increase in risk.

One in six respondents said they saw a need for greater board attention to cybersecurity.

The survey was conducted in January 2021 and reflects responses from 188 independent directors, chief executive officers, chief risk officers and other senior executives of U.S. banks below $50 billion in assets. The largest group of respondents had assets between $1 billion and $10 billion (43 percent), followed by banks under $500 million (26 percent), banks between $500 million and $999 million (22 percent) and banks over $10 billion (9 percent).