FORTRESS PARTNERS
***E*-Memo**

TO: INVESTORS/MEMBERS/PARTNERS AND FRIENDS
FROM: Scott McCallum & Jon Bruss
DATE: February 28, 2018
SUBJECT: **CEO Succession and Emergency Planning: Timely Topics for Community Bank Boards**

In the past few years, we have seen a lack of management depth, succession or continuity as factors in community banks deciding to sell—in addition to getting good pricing!

It is a governance best practice for community bank boards to take a more proactive role in stimulating discussions about near-term and longer-term needs for talent. We acknowledge that there are natural sensitivities and barriers when the term "succession" is raised: Board members are not usually comfortable discussing it, especially given the current CEO's institutional "presence". And CEOs may feel some paranoia or inferiority, especially given the perception of the potential loss of control of their own future.

Back in our October *E*-Memo, we mentioned a *Wall Street Journal* op/ed from the August 29th edition, entitled "Why Would Anyone Sane Be a Bank Director" by Thomas Vartanian (a practicing attorney and former general counsel of the Federal Home Loan Bank Board). That article was about the "rising dough" syndrome of regulation and the blurring roles of bank managements and boards.

According to Vartanian, the Fed had come to believe that "[b]oards that meet periodically cannot effectively undertake management's day-to-day operational responsibilities, or the oversight role of regulators." Furthermore, the Fed now "wants to improve corporate governance by having boards devote less time to satisfying supervisory expectations that to do not directly relate to their core responsibilities, and devoting more time to what really matters, such as establishing strategy and risk tolerance and holding senior management accountable."

Our take on that op/ed: That would truly be a breath of fresh air and, also facilitate a shift in focus to strategy, executive succession, shareholder value enhancement and senior management accountability—four worthy duties for community bank boards.

In a January 19, 2018 *BankDirector.com* article entitled "Seven Secrets of Succession Planning," Allen J. Kaplan (founder of an executive search and talent advisory firm) mentioned "one of the bank board's most vital responsibilities is overseeing the plan for succession for the CEO." He goes on to state that "unfortunately, too many bank boards take a passive approach to CEO succession, rather than acknowledging as directors, they are responsible for the selection and ongoing evaluation of CEO performance."

He further maintains that "good succession planning starts with an understanding of the potential succession timeline and the bank's strategy. He lists five additional steps, which are:

1) Identify key skills—leadership attributes, relevant experiences
2) Determine critical attributes—personal style, presence, leadership philosophy
3) Develop a process—robust and thoughtful approach for finding, vetting and retaining a CEO
4) Make your bank attractive to talent—"the crop of qualified bankers available to fill the growing ranks of retiring CEOs is not deep enough"
5) Prepare for an emergency—being able "to keep the train on the tracks during an unexpected situation is critical to keeping the institution moving forward."

Speaking of emergency, we know of a community bank in which the CEO came down with a severe illness leading to hospitalization and a lengthy recovery that kept him out of the bank for several months. The board and executive team were able to keep the "train on the tracks", in terms of customers, staff and regulators, by identifying and mapping the CEO's main responsibilities among the board chairman (who had a long banking career), the CFO, the Chief Risk Officer and Chief Banking Officer. The result was the bank could run smoothly, and one senior person, in particular, demonstrated their value-added to the enterprise, the CEO and the board for future cultivation.

In conclusion, and notwithstanding the potential barriers mentioned earlier, we strongly recommend that bank boards proactively engage in CEO succession planning—for both emergency and longer term purposes. Use the steps outlined in the *BankDirector.com* article as a guide.

We plead guilty if asked how we positively impacted governance best practices as applied to succession planning. We've discussed it in open sessions with the boards on which we served. We did get some pushback from CEOs who appeared to be hurt or threatened by the suggestion. In fact, and for the benefit of the institution and its ownership, the CEO should have broached the subject with the board in the first place. To get the ball rolling, the board should operate in executive session, but the current CEO should know it's happening and should provide valuable input.

The goal is to keep the "train on the tracks" and establish a best practice community bank board governance process.

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