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# The Honeymoon Is Over: Managing the Board and CEO Relationship During Times of Stress

STEPHEN G. MORRISSETTE AND CHRISTOPHER J. ZINSKI

*The authors of this article offer guidance on various tactics for addressing conflict and stress between boards of directors and CEOs during this severe credit crisis, as well as advice on how to prepare for likely future stress — whether the source is tension over company performance, a serious public relations issue, pressure from the regulators or another form of boardroom conflict.*

Imagine this scene between a disgruntled bank director and the CEO.

Director: *How did these bad loans happen? We thought you knew what you were doing!*

CEO: *These were good loans when we made them. The economy has gone south and you guys agreed and approved these deals.*

Director: *But we're not bankers. You were supposed to know. Now the regulators are all over us.*

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Does this exchange sound familiar? It has occurred in countless bank boardrooms across the country during the last two years. For most directors and CEOs, this is their first experience living through a severe credit crisis — considered by economists the most severe since the Great Depression. Some lived through the agriculture loan crisis of the 1980s and, for those who were around 25 years ago, they may recall the commercial real estate and S&L crisis. But most loan officers, CEOs and directors were not around during these prior crises and are now learning how to manage a bank — and manage boardroom tensions — during a severe credit crisis. As such, dialogues such as the stereotype above are frequent. Also, many banks had been extremely successful for the 10 years prior to the 2008-2009 banking crisis; the sudden and dramatic fall from the heights of success has intensified emotions and created feelings of disillusionment. The honeymoon is over; we now have trouble in paradise. While the tension is mostly typically between the board and the CEO, we also have seen tension amongst directors and between CEOs and senior officers.

Whether your bank board (or your client) is currently experiencing some form of board level conflict or stress, or if it is one of the few boards free of it for the time being, this article will guide you through various tactics for addressing conflict and stress as well as how to prepare for likely future stress — whether the source is tension over company performance, a serious public relations issue, pressure from the regulators or another form of boardroom conflict.

This article will guide you through handling boardroom disputes by addressing the following steps:

- Recognition: Is this actually a dispute or simply healthy debate?
- Engagement: Should we deal with it now or let it go away?
- Facilitator Selection: Who will facilitate the resolution?
- Resolution Process: How will the facilitator resolve the dispute?
- Diagnosis: Why did this happen and how do we deal with the root causes, not just the symptoms?
- Future Planning: What do we do now, and how do we plan for future disputes?

## RECOGNITION: KNOWING WHEN YOU HAVE A DISPUTE

Recognition that there is a dispute is perhaps the most difficult step in the process. Good boards should have energetic discussions and debate; "dynamic tension" is a hallmark of a successful board.[1] This article will use the term "debate" to describe healthy board discussions and use the term "dispute" to describe those situations that are less healthy and need resolution by additional governance tactics.

A quote from former General Motors CEO Sloan is relevant: "Gentlemen, I take it that we are all in complete agreement on the decision here," he started, and everyone nodded their heads in agreement. "Then," he went on, "I propose we postpone further discussion of this matter until the next meeting to give ourselves time to develop disagreement, and perhaps gain some understanding of what the decision is all about."[2]

So, how is a board to know when it is engaged in healthy debate or has a dysfunctional dispute? A few possible signs that the issue has moved to the realm of dispute:

- The issue does not get resolved but continues to "flare up" at board meetings over many months;
- The issue has divided the board into "camps" or has divided management from the board;
- The dispute "goes public" and becomes known to the firm's employees, stockholders, customers or community;
- The dispute consumes too much board meeting time and interferes with making other decisions that are not related to the dispute;
- The board begins doubting the CEO's recommendations and/or increasingly turns to attorneys and/or consultants on key decisions;
- Old wounds resurface and previous undercurrents boil over ("we pay him too much," "he doesn't tell us enough about loans," "he's never been enough hands-on", etc.);
- Too many conversations occur between individual directors outside the forum of a board meeting on a particular issue and complaints arise that the board is not effectively addressing it in open session.

It is important to note that disputes are to be expected. Just as intense competition in a football game can sometime escalate into fisticuffs, so too can healthy boardroom debate sometimes cross the line into unhealthy disputes. Disputes or fights in a football game should not be surprising given the participants: intense, competitive and physical players. Likewise, occasional disputes should not be surprising in the boardroom, especially in community bank boardrooms where the board members are typically successful and strong-willed business leaders, often with very diverse backgrounds, management and communication styles. As an added catalyst, banking is a business with wide cyclical swings, and bank success — and failure — is very dependent on the judgments made in good cycles that are sometimes proven "bad" during down cycles.

## ENGAGEMENT: SHOULD WE DEAL WITH IT NOW OR LET IT GO AWAY? CAN WE DEAL WITH THIS WHILE UNDER SIEGE?

While it can be difficult to discern the difference between debate and dispute, the greater difficulty is deciding to address the dispute once it is recognized. Again, given the diversity of the board, some members will wishfully view a situation as a debate, while others will see it as a dispute. The most insidious problem with dispute resolution is denial. Psychologists have well documented the general preference for humans to avoid negative situations and conflict. Despite the fact that boards are typically comprised of assertive individuals with good communication skills, the human propensity for denial is clearly present in boardroom dispute situations but must be overcome. Directors must move from denial to resolution.

When in doubt, best practice recommends that repeated, emotional "debate" is better viewed as a "dispute" that must be addressed using alternative governance tactics. Boards are better served by erring on the side of action rather than denial, and we urge a board to get the dispute on the table and deal with it now, not later.

Research shows that unresolved disputes will resurface. In fact, current disputes are often the result of prior unresolved disputes that were repressed, festered and eventually erupt somewhere else. Contrary to our denial, disputes typically do not go away or solve themselves; they just go dormant or

underground until rekindled by some future catalyst.

Why are directors uncomfortable suggesting an issue is a dispute that needs to be addressed? What is the "cost" to them or the organization if they are wrong and there is no dispute? No director wants to worsen a situation by labeling a healthy debate as a dispute. Generally directors do not want to be viewed as trouble makers or as "crying wolf." While outside the scope of this article, there is significant literature that examines why directors desire to "conform," are unwilling to "make waves," and are especially loathe to challenge the CEO lest they risk that the CEO/chairman not nominate them for re-election to the board.[3] While these risks/costs are real and not to be dismissed lightly, we think the cost to the board in not resolving a dispute is much greater.

So, what are the costs of denial? They can be substantial:

- Disputes are a significant drain of time, energy and emotion. Contrary to the "we can't deal with this in the middle of a storm" train of thought, is the ship safe if the crew is fighting with each other rather than battling the storm and minding to the safety of the ship? If you were a tribunal asking why the ship went down in the storm, how would you react to testimony that the captain and two of his officers were busy arguing in his cabin while the ship floundered?
- Disputes can interfere with unrelated decisions. Many times a dispute undermines the decision process and culture of the board and poisons other decisions unrelated to the dispute. If the board or some board members have lost faith in the CEO due to a dispute on one matter, do they trust his recommendations on other matters? If the board has divided into factions over a dispute, does this affect the way they make other decisions?
- Disputes are more "public" than directors often realize and, as such, impact the morale and productivity of the bank's officers. Employees notice when the board starts having more frequent meetings and when they have meetings without the CEO present.
- Some officers and directors will solve the dispute with their "feet." They will resign. The loss of a key officer and/or director over a resolvable

dispute is a high cost to pay, especially when we need all hands on deck dealing with the storm.

- Bank regulators very much want boards to help steward the ship to safety. They want to see all hands on deck, working hard, pulling in the same direction to ensure survival. They want to see action. A board paralyzed and unable to act due to denial or a dispute does not fit the regulatory definition of safe and sound leadership (see Directors' Duties and Liability).
- Unresolved disputes can lead to a "balkanization" of the board. That is, rather than the board splitting into two factions over a dispute, the board could split into multiple factions, making it all the more difficult to find consensus. That balkanization over the one dispute can cause multi-faction position-taking on other issues as well, paralyzing a board.

Comparing the social costs of being a "trouble maker" who "cries wolf" with the significant costs of ignoring a dispute, it is recommended that directors err on the side of pointing out a potential dispute and suggesting the board resolve it rather than ignore it. Deal with it before a dispute gets out of control and results in directors resigning or a CEO being fired for the wrong reasons.

If a director overcomes the gravity of denial, how does he get the issue on the table? Typically, a director with concerns has already had sidebar conversations with other directors and/or the CEO about the issue. These sidebar conversations are a lower-risk first step before discussion at a full board meeting. At some point, a director can simply say: "We've been wrestling with this issue for several meetings and there has been a fair amount of heat about it. I'm wondering if we should try another way to resolve it. Maybe we should have a separate meeting or create a sub-committee or something."

## FACILITATOR SELECTION: WHO WILL HELP US FACILITATE A RESOLUTION?

The process of dispute resolution cannot begin until it is determined who will help facilitate the resolution. Unfortunately, many directors believe there is no person who can help with this. That belief is not the case.

## DIRECTORS' DUTIES AND LIABILITY

Directors of financial institutions and their holding companies owe fiduciary duties to the bank or the company they serve. While the duties described may differ slightly depending on variances in state law, they can be succinctly summarized.

- Duty of Care. Directors have a duty to act as a reasonably prudent person would under like circumstances. In doing so, directors should act on a fully informed basis.
- Duty of Loyalty. Directors, in making determinations, need to act without personal self- interest in the matter. If they have a conflict of interest in a matter under consideration, the director should disclose the conflict to the full board and, if necessary, abstain from voting on the matter.
- Duty of Good Faith. Directors have a duty to act with honest intent in putting the best interests of the bank or holding company first in their decision-making.

As a general rule, if directors satisfy these duties they will be accorded the protection of the business judgment rule, which provides that their business decision will not be subject to second guessing by a court.

Directors of financial institutions today face tangible threats of personal liability given the current distressed operating environment for banks, a high level of bank failures and severe diminution in stockholder value compared to values from several years ago.

While the duties and concepts mentioned are corporate law concepts and apply to directors of financial institutions, the bank regulators have their own perspectives

Whoever is charged with the facilitation process faces a daunting task: the person or committee must deal with communication issues, be able to frame issues effectively and clearly, earn and maintain trust, reconcile inconsistent understandings of the situation, and address effectively emotions in a "high stakes poker" situation — oftentimes the CEO's job and the bank's survival are at risk. There are numerous options to deal with boardroom disputes and to determine who is best equipped to facilitate the process, which is outlined in the following:

- Special Meeting: Often boards have more success focusing on a specific issue at a special meeting rather than buried in the middle of a regular board meeting or at the end of the meeting when members are tired and need to move on to their next appointment. A special meeting allows the board to devote an appropriate amount of time and focus to discuss and resolve the issue. Moreover, issues that are complicated or involve disputes should often be "held over" to a second meeting or even a third, thus giving directors time to digest and process the issues between meetings.
- Board Sub-Committee: Depending on the size and composition of the board, a sub-committee can be effective at doing the hard work. Many conversations, especially difficult ones, are often more productive in a smaller group. However, this tactic should not be viewed as "let's get the two parties in a room with a referee and let them fight it out." The committee should include "non-combatants" (hopefully the dispute has not engulfed the full board). The group should also be composed to ensure a balanced and fulsome discussion. A key issue for this tactic is how to get full board support for the resolution developed by the sub-committee. Using the chairman of the board — so long as the chairman is not CEO — or the board's independent director, if it has one, would be the right director to suggest a sub-committee format and help the board determine who should be on the committee and the scope of the committee's work. Getting the committee established the right way in the first instance will be critical to putting the dispute on the right path for effective resolution.
- Emissary/Peacemaker: Some boards have effectively used a director to act as a "peacemaker" or facilitator to work with the individuals in conflict. While the inside facilitator approach is very common and often effective,

many boards do not have a member able or willing to play this role, or many times the dispute has spread so that every director is now a "combatant." When a board begins to focus on whether or not it has an emissary that can play peacemaker, it starts to move forward constructively.

- Outside Facilitator: As one board member described: "What we need is a marriage counselor." The analogy is quite reasonable — especially as it relates to board-CEO disputes. Like a marriage, the board and CEO typically have a close relationship (often directors are personal friends of the CEO) and trust is a key attribute of the relationship. Like many marriage counseling situations, it is a situation where a long-term relationship has an incident where trust has been challenged, even creating a sense of betrayal. Also, as is typical in marriage counseling situations, there are likely to be communication problems in the relationship. An outside facilitator can bring dispute resolution experience and objectivity, and is not a "combatant" that has scar tissue to overcome nor has a vested interest in a particular outcome. However, the challenge with this tactic is to identify an outside facilitator who the board can trust and who has an understanding of the special challenges faced by bank boards and CEOs.

Certainly, it is important to select the resolution facilitator who fits the dispute to be resolved and matches the dynamic of the board. For instance, if the CEO has strong control over the board or if there is one dominate director involved, it may be difficult for one director to play peacemaker and the sub-committee tactic may be more effective. If the board has an outside director as chairman, not the CEO, it may be possible for the independent chair to act as facilitator consistent with his role as independent chair. One important caveat to picking a resolution process and facilitator is to realize that not everyone uses the same approach to dispute resolution — which in itself creates tension as directors work to select a resolution process. In reality, a resolution may require multiple tactics so that different directors' styles can be accommodated. In the group process solutions (special board meeting or board sub-committee), certain individuals naturally evolve into the role of facilitator. It may behoove the board to select the facilitator rather than let one individual grab the role.

Identification of an inside facilitator is typically an intuitive process; however, selection of an outside facilitator often elicits more questions about qualifications and fit. Whether choosing an inside or outside facilitator, it is important to keep in mind this checklist of general factors to consider:

- Board experience: Is this person experienced as a director or an advisor who has regularly attended board meetings?
- Facilitation skills: Will this person facilitate a solution arrived upon by members and not provide the solution themselves?
- Personal traits: Is this person patient and a good listener and will the facilitator refrain from judgment?
- Confidentiality: Take special care if you determine to use a "local person" as it poses higher confidentiality risks and be sure, in any event, to have him sign a confidentiality agreement.
- Situation knowledge: Does this person understand the board's unique situation and can this person still maintain neutrality and independence?
- Knowledge of corporate governance best practices and legal issues: This person must understand the unique nature of the dynamics between board/governance and CEO/management.

Once the board has gone through the checklist, there is another question to ask: Will the board chair view the outsider as a threat to his authority? Will the CEO? Does any insider have sufficient time to devote to the facilitation process? Will the board consider the insider to be neutral or advocating its position?

When selecting an insider (a director or officer) to be the facilitator, the default selection may be the board chair (if not a combatant in the dispute and not the CEO). Another option would be a chair of one of the board committees, such as chair of the Governance Committee. In one situation, a bank effectively used a former director as facilitator. This "quasi-insider" was known and trusted by the board and understood much about the bank's situation; however, she was not a participant in the current dispute and, therefore, could bring objectivity.

Attorneys and consultants are the most common outside facilitators. Attorneys often deal with disputes in their legal practice and many have experi-

ence dealing with boards. In fact, many boards turn to the bank's attorney for assistance. One factor to consider is that attorneys often focus on the legal perspective even though the dispute is not normally a question of law or determination of facts. Also, attorneys are trained to win arguments as opposed to resolve disputes. Moreover, their inherent risk aversion may affect their ability to lead the board in a "higher risk" direction when that is exactly where the board needs to go.

If the board is considering a consultant, they must decide if process/dispute resolution expertise is most important or if it is more important that the consultant understand banking and bank boards. Because banking is highly regulated and bank boards have unique responsibilities (e.g. credit approval) not existent in other boards, our experience indicates that most banks use consultants with deep banking experience rather than a generalist facilitator, often turning to a consultant who was a former bank CEO or board chair.

While we have seen many types of facilitators effectively help boards resolve disputes, we observe that outside facilitators are particularly advantageous dealing with trust issues and other emotions. Here a neutral, third party can be invaluable. Facilitation costs are a common way that boards justify ignoring the dispute. Depending on the complexity of the dispute, a facilitator may cost $5,000-$25,000. However, as discussed, this cost seems small in comparison to the cost of countless special board meetings, cost of negative impact on team morale/productivity, impact on CEO productivity, cost of losing directors, and the high cost of transitioning to a new CEO.

## RESOLUTION PROCESS: HOW WILL THE FACILITATOR RESOLVE THE DISPUTE?

In this difficult situation of boardroom dispute, many facilitators use a process with the following phases:

- Framing: Establish the facts of the situation, surface the emotional issues, carefully define/narrow the scope of the dispute, agree upon process and ground rules, and agree upon objectives.
- Dialogue: Emphasize active listening, try to externalize the problem rather than personalize it, use an appropriate mix of the full group, small

group and one-on-one discussions, and understand key positions and interests.

- Resolution: Generate and consider alternative solutions, select best fit solution, ensure full board understanding of resolution, and document resolution to ensure clarity and for future reference.

While it is not the intent of this article to be a detailed manual for facilitators,[4] we do offer a few insights and suggestions on dispute resolution based on our experience with bank boards.

First, we are struck by the significant trust issues in most bank boardroom disputes, and it is especially concerning to see a downward spiral in trust as issues and disputes go unresolved. It is not just a deterioration of trust between the board and CEO, but also between board members and between the CEO and other bank officers. Unresolved disputes can cause erosion in trust that can have lasting consequences. Again, we urge boards to deal with these issues rather than stay in denial and let trust disintegrate beyond repair.

A second issue requiring attention is the power imbalances that exist in a board room. The first and most obvious is that the CEO is the only person in the room who can be fired. However, since the CEO is also a director with fiduciary duties, his or her role and participation in the resolution discussions is complex. The independent directors should be mindful that the CEO may feel very isolated and threatened. Many bank directors own their own business — so they can't be fired — and/or have significant personal wealth. As such, they might not understand the position of a CEO who has devoted his life to building the bank, who relies on the bank for his income, and whose bank stock may represent a very large percentage of his personal net worth.

Due to these various factors, it is beneficial for the CEO to have someone serve as a sounding board or confidant during dispute resolution discussions. Unfortunately, the bank's attorney can most likely not play this role since he is bound to represent the institution's best interests, not the CEO's interests. Furthermore, using an attorney as a confidant can appear to escalate the dispute. And since CEOs do not want to "air [boardroom] dirty laundry" with other officers, it may be problematic for the CEO to use a bank officer for this role. One of the effective solutions we have seen is for the CEO to identify a consultant, often a former bank CEO or retired chairman, who has experi-

enced similar situations in his career and can provide grounded perspectives on the dispute.

There are other power imbalances that should be addressed, such as dominant directors or directors with large/controlling ownership percentages. In spite of the liability shared by all directors, we have seen repeated situations where directors with smaller ownership percentages defer to directors with larger ownership percentages. It is important to keep in mind that all directors equally share liability regardless of their personal holding of the company's stock, and that their fiduciary responsibility is the same as the larger stockholder.

Regardless of stock ownership imbalance, most boards have directors who are more vocal and/or more influential. We have sometimes seen entire boards "hijacked" by a dispute created by one or two dominant/influential directors. Given the normal human tendencies to avoid confrontation discussed above, it is not surprising that less vocal directors would find it especially difficult to make the board address a dispute where a primary combatant is an influential director. When an influential director and CEO "lock horns like two strong bulls," it is understandable that everyone's first reaction is to get out of the way.

A third process issue is the importance of using executive sessions in an appropriate and productive manner. Many directors feel uncomfortable asking for an executive session and many CEOs seem offended when the board does so because the CEO and other members of management are excused from the session. Scheduling routine executive sessions eliminates the need for a director to ask for one. A governance culture that provides a forum for independent director discussion is healthy and beneficial. Oftentimes the breathing space of executive session enables a director to surface an issue that might not get brought to the table in regular session. It also makes explicit the dual role of the CEO as an officer and director. The independent directors have the right and duty to discuss certain matters free from the CEO's influence. However, one caveat: executive sessions should be used primarily to discuss personnel matters, including performance reviews, and other highly sensitive issues. It is inappropriate for the board to intentionally exclude any director from discussions of bank policy or strategy. We have seen situations where executive sessions morph into broader discussions that should have

included the inside directors, so awareness and appropriate management of this possibility during the session is important.

Another complication: many boards have additional inside directors (officers that serve on the board in addition to the CEO). The need for appropriate use of executive session is more important if the board has non-CEO inside directors and the caveat about excluding directors from policy/strategy conversations also becomes more complicated. It is also worth noting that best practice for public company banks is that a board have only one inside director, the CEO.

Following the executive session, best practice is to have one or two directors communicate the results to the CEO. CEOs understandably can be concerned about what deliberations took place in executive session. Additionally, if the board is frequently having separate meetings in executive sessions, they might want to consider doing so offsite because, as mentioned earlier, bank staff often notice these special meetings, especially if the CEO is excluded, and there can be a negative effect on bank morale.

Our fourth process suggestion relates to common process pitfalls to avoid. The first pitfall is using e-mail as a communication tool when dealing with disputes. Tone and non-verbal communication elements are even more important when addressing a dispute and dealing with topics that involve perception and emotion. Interestingly, some directors use e-mail more often when addressing a dispute which is consistent with the human desire to avoid confrontation. Many perceive e-mail as a less confrontational style of communication and find it preferable to face-to-face conversations about difficult topics; however many individuals use a more aggressive style in e-mail than they do for in-person communication. Another consideration is that communication between directors or between directors and the CEO is not privileged communication and this issue needs to be carefully evaluated with counsel. Research has documented the deleterious effects of e-mail for these types of communication.[5] Interestingly, medical research has shown that face-to-face meetings including eye contact and shaking hands releases brain chemicals which reduce fear and anxiety.

Another common pitfall is to expect the facilitator to provide a solution. A good facilitator should help the participants develop *their* solution. The board must develop and own the solution; it cannot be provided by or

imposed by an outsider. Similarly, it is important that the solution be owned by the entire board. While a sub-group or sub-committee may be more involved in the dispute resolution process, eventually the resolution must be embraced by the full board. A related pitfall is that not everyone will understand the resolution in the same way. We recommend that there be some written understanding of the resolution. This will help ensure that everyone has a common understanding and can prove very valuable as time passes and recollections fade or are somehow "revised" as subsequent events related to the dispute occur. Also, a written document helps create a sense of closure to the resolution process.

We also offer some additional process suggestions based on our experience with many bank board disputes resulting from the recent recession and credit crisis. First to boards: accept responsibility for your role that brought the bank to this point. Some boards are quick to blame the CEO and wash their hands of any responsibility. The bank's performance problems may not just be execution mistakes by the CEO, but also governance, policy and risk tolerance judgments made by the board; after all, the board controls concentration risk decisions and overall loan policy. Also, it is unique to the banking industry that the board is more involved in execution — it has to approve loans. As discussed hereinafter, we find that many disputes are rooted in governance process issues, not simply officer performance problems. Disputes become easier to solve when people acknowledge their role in the problems.

We also encourage the board to talk with the bank's attorney to clearly understand its duties and liabilities. In fact, its duties may change when the holding company and the bank's solvency is in question.[6] In almost every situation, we have advised clients that the board needs to have an education session to ensure it fully understands its duties and liabilities. Do your directors have a clear understanding of their legal duties? Additionally, the board must consider when it needs its own legal representation. Lastly, the board should periodically have its D&O coverage reviewed by an attorney who specializes in this area.

Boards also need to be mindful of the "grass is greener" syndrome. Many boards seem to think replacing the CEO will be a magic pill. Will the new CEO be more competent and committed than your current CEO? If your bank is under regulatory process such as a consent order, what type of execu-

tive will accept the position? However, we do recognize that there can be significant value from having a fresh set of eyes look at a credit portfolio — most lenders and bank officers have difficulty accurately seeing the deficiencies in their portfolio. In general, we find that banks focused on action necessary to improve are more successful than those that spend months playing the "blame game."

Our advice to CEOs starts in the same place as our advice about boards: accept responsibility. The CEO was the "banker" at the helm. Overall, CEOs should recognize that the denial problem discussed throughout this article is most prevalent with CEOs. This is likely the result of several factors: difficulty seeing the forest for the trees; total absorption with the severe challenges facing the bank inhibiting the ability to step back and diagnosis the situation; CEOs often feel they must lead the team by staying positive rather than acknowledging the negative; and CEOs may be reluctant to confront discomforting information.

We observe that effective CEOs acknowledge the bank's challenges and the mistakes made — and then move to become part of the solution. While we do not think it is typically necessary, some CEOs have even apologized to their board. We encourage CEOs to solve the dispute over bank performance problems by leading the charge forward rather than fighting to defend past decisions. Rather than fight the board and position themselves on the opposite side of the table, CEOs are better served by embracing the need for change and leading the restructuring plan. Key to this effort is a CEO acknowledging to the board that he/she has made a realistic assessment of the situation, has the tools to attack the problems and has developed a strategic and tactical plan for presentation and review by the board.

## DIAGNOSIS: WHY DID THIS HAPPEN AND HOW DO WE DEAL WITH THE ROOT CAUSES, NOT JUST THE SYMPTOMS?

Another important consideration for resolving board level tension is to understand the root causes of the dispute. Often the true source, the "why" of the current dispute, is related to the bank's governance process. The catalyst of the dispute may be loan charge-offs or a regulatory action like a Memorandum of Understanding or a Consent Order; however, the board should ask

why this happened. If the board traces the chain of cause and effect by asking penetrating "why" questions, it often leads back to the board's governance process. Many boards realize they were not properly involved in setting risk parameters for the bank or overseeing compliance, understanding loan risk concentrations, understanding how lending strategies had drifted away from the bank's historical business strategy and towards more risky waters.

An introspective "why dialogue" often also uncovers an unhealthy understanding of the role of the board versus the role of the CEO. Many bank CEO's view their board more like an "advisory board" than "governing board." Likewise, many bank directors view their directorship as an honorary role similar to serving on a university or hospital board. The recent banking stress has caused many bank boards to properly redefine their role from a "social/advisory" to a "fiduciary/governance" role. This transition is often the root cause of many of board level disputes first perceived as a dispute over loan problems or CEO performance. The role of the board versus the role of the CEO has always been difficult to understand and implement; hence, the countless articles and consulting engagements related to this inherent tension.[7]

Another typical root cause of disputes is how communication is handled in the board's governance process. A discussion of board communication tactics is a large and important topic outside the scope of this article; however, we encourage boards to consider what communication process improvements they could make to help reduce the probability and severity of future disputes.

It is also important to understand if the dispute is simply a "rough patch" or if the dispute has revealed a root cause that points to CEO performance/qualification problems or, conversely, the dispute might point to board performance/qualification issues. Is this a marriage that can/should be saved? How does the board evaluate its performance? We know the board can fire a low-performing CEO but who fires low-performing board members?

## FUTURE PLANNING: WHAT DO WE DO NOW, AND HOW DO WE PLAN FOR FUTURE DISPUTES?

Best practice boards will think about how to handle the inevitable future disputes. Who does a CEO turn to if he feels that he is having a dispute with a director or the full board? How does the board make it easier to identify

and resolve small disputes before they become large ones? Interestingly, when recruiting directors, some boards look for a candidate with skills or characteristics that can help with dispute resolution.

Unfortunately, boards tend to overlook the potential for disputes and do little planning or board education in preparation for them. Most governance experts agree that best practice boards include a dispute resolution process in the board policy, include dispute resolution training, and even consider conflict-resolution skills when recruiting new directors.[8]

## CONCLUSION

These are difficult and turbulent times for banks, which often lead to board level disputes. If the board acknowledges the dispute and sets upon a process to resolve the current dispute and even prepare for future disputes, the board and the bank can emerge stronger and better having navigated the difficult experience.

## NOTES

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