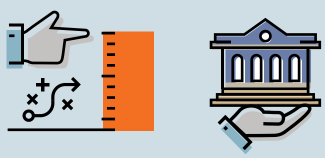
2021 Governance Best Practices Survey

Insight Into Critical Issues for Bank Boards

KEY FINDINGS



BOARD PRACTICES

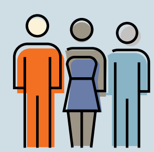
Respondents say that holding management accountable for achieving strategic goals (**61%**) and meeting their fiduciary duties (**60%**) are the most important functions of their bank's board.

SETTING STRATEGY

56% says the board sets the bank's risk appetite but management develops the strategic plan.

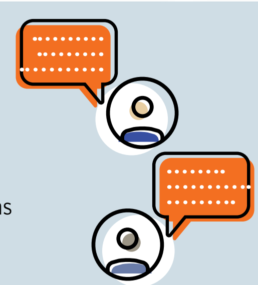
REFRESHMENT & DIVERSITY

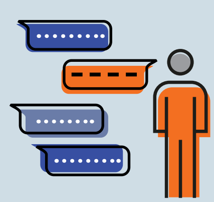
65% believe their board should recruit more diverse directors.



BOARD-MANAGEMENT RELATIONSHIP

74% have several directors willing to ask tough questions when warranted.





INDEPENDENT DIRECTORS

72% feel free to exercise their independent judgment without hesitation.

2021 Governance Best Practices Survey

"Different genders and ages of board members allow for unique perspectives. These perspectives provide for more thoughtful strategic conversations with executive management about the future of the bank."

"I can't tell how diversity has helped. We make the best decisions we can as a board, and I don't see where it has helped or hurt."

Jack Milligan is editor at large for Bank Director.

Emily McCormick is vice president for research for Bank Director.

Building a diverse board —as defined by gender, race and ethnicity — is a controversial issue in many corporate boardrooms today, banks included. An increasing number of large institutional investors and stock exchanges like the Nasdaq Stock Market are pushing for it, and a small but growing number of states either mandate it or are instituting disclosure requirements. But not everyone is convinced that greater diversity inherently leads to better governance, as illustrated by comments like the above received in Bank Director's 2021 Governance Best Practices Survey.

Diversity is just one of many issues covered in this year's survey. The list includes the practice of credible challenge, the desire for collegiality versus the freedom to disagree, board assessments, the board's role in strategic planning and CEO performance evaluations.

Sponsored by Bryan Cave Leighton Paisner LLP, the survey polled 217 directors and chief executives at banks under $50 billion in assets in February and March of 2021. The majority of the respondents were independent board members. Almost half of the participants represented banks with $1 billion to $10 billion in assets.

The analysis of the survey results presented in this report has been divided into five modules: board practices, the board/management relationship, strategic planning, board refreshment and diversity, and the role of the independent director. We relied on the insights of three experts in corporate governance, beginning with James J. McAlpin Jr., a partner at Bryan Cave and leader of the firm's banking practice group, who advised us on the survey questions and helped us interpret the results. Also helping us sort through the survey findings while sharing their board practices were David L. Porteous, the lead director at Huntington Bancshares, a $175 billion regional bank holding company in Columbus, Ohio; and C. Dallas Kayser, the independent chair at City Holding Co., a $5.9 billion financial holding company headquartered in Charleston, West Virginia.

The survey instrument was designed and executed by Emily McCormick, Bank Director's vice president of research.

This is the second consecutive year we've conducted the Governance Best Practices survey, and we expect to make it an annual event for many years to come. We have learned over the past two years that well managed, high performing banks can have very different practices and opinions on various aspects of corporate governance. For example, 43% of the survey participants conduct an annual board evaluation, and another 21% perform a less frequent assessment. Huntington does an annual board assessment and every few years will bring in an outside consulting firm to perform a more extensive review of its governance practices, along with an evaluation of each board member. City Holding, on the other hand, is one of the 36% of surveyed banks that do not perform a board assessment. Yet, both banks have a history of high profitability, and I would judge each to have a strong corporate governance culture.

However, there is one "best practice" in bank governance that will always be absolutely essential — a group of highly engaged independent directors who feel empowered to speak their minds. And when that doesn't exist, most other governance practices are a hollow exercise.

BOARD PRACTICES

When asked to identify their board's three most important functions, survey respondents placed almost equal importance on holding the senior management team accountable for achieving the bank's strategic goals in a safe and sound manner (61%), and meeting their fiduciary responsibilities to the bank's shareholders (60%). Thirty-four percent identified setting the bank's strategy as a key responsibility, followed by establishing the bank's risk appetite, and its values, mission and vision — both at 30%.

An overwhelming majority of respondents, at 91%, said they believe their board's agenda regularly includes the relevant issues facing their institution. McAlpin says a best practice for setting meeting agendas is for the CEO and independent chair, or lead director if the CEO is also the chair, to work together to determine what topics or issues should be put on the agenda. "He or she who controls the agenda also controls the board meeting," he says.

At Huntington Bancshares, Lead Director Porteous prepares for the board's regular quarterly meetings by reaching out to the entire board, including Chairman and CEO Stephen Steinour. "I call every board member, usually a month or two before our board meeting, and talk to them about the bank and any issues that they would like to make sure that we're covering," he says. "Then I talk to Steve about those." At City Holding, President and CEO Charles "Skip" Hageboeck and his management team usually prepare the agenda for the board's monthly meetings with input from the independent directors about specific topics they want to see addressed. "I have a conversation with Skip at least once a month regarding the agenda and things that may be coming up for a vote that need further explanation or discussion," says Kayser.

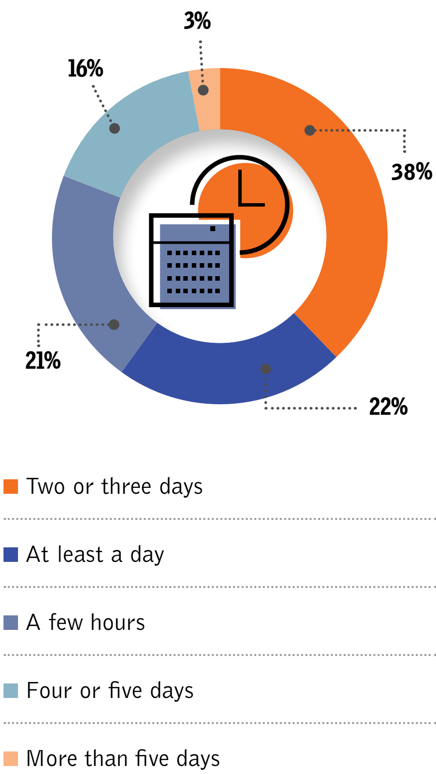
Responses were widely distributed when the survey participants were asked how much time they needed to review board materials prior to a meeting. Thirty-eight percent said two or three days, 22% said at least a day and 19% said four or more days. Twenty-one percent said just a few hours!

The widespread adoption of board portals that enable reports to be distributed digitally (85% of the respondents to last year's survey said they receive their board packets this way) have contributed to an explosion in often-dense content that directors are expected to fully review prior to every board meeting. It can be a challenge to get through it all in time. City Holding generally distributes its board package on a Friday prior to its board meeting the following Wednesday. The packages can be 400 to 500 pages, and directors are expected to review all the material and be prepared to ask questions. "Four to five days gives us plenty of time normally to review everything and be prepared for the meeting," Kayser says.

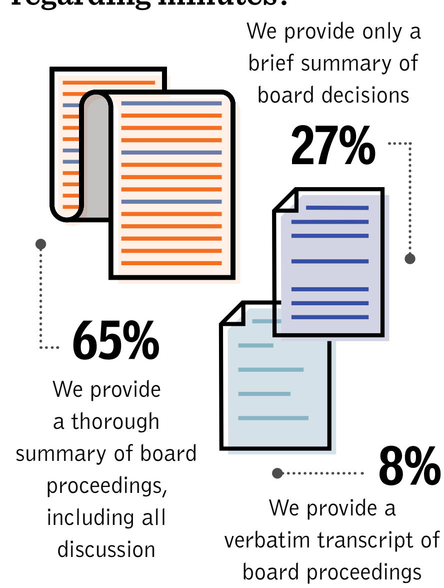
Huntington tries to ameliorate information overload by providing a short executive summary "regarding the points that are critical for there to be discussion on and the points that are essential for action," Porteous says. "That might encompass two or three pages ... and we will attach appendices [with] additional detail that [directors] based on their knowledge or experience may want to analyze even further." Huntington also distributes its board reports over a rolling two-week period rather than in one big dump.

Sixty-five percent of the survey respondents said their board meeting minutes provide a thorough summary of their proceedings, including all discussions. This is generally considered to be a best practice by governance experts, and both Huntington and City Holding follow this approach. Interestingly, 27% said they provide only a brief summary of board decisions, and 8% said they provide a verbatim transcript of their board meetings. McAlpin, who routinely advises boards on governance matters, says verbatim transcripts are a dangerous practice. "Having sat in on many depositions over the years, I can tell you that is not a best practice. In fact, I think it's borderline dangerous to record every word said by a director during a board meeting."

How much time do you believe you need to review board materials?



What is your board's practice regarding minutes?



THE BOARD/MANAGEMENT RELATIONSHIP

Transparency is an implicit factor in a healthy relationship between the board and its senior management team, with the board receiving all the necessary information to perform its oversight function. Ninety percent of the survey participants said they are getting the right level of information from bank management, with 9% saying they get too much information and just 1% saying they don't get enough.

When asked who the board interacts directly with on at least a quarterly basis, 98% said they meet with the CEO, 94% with the CFO, 85% with the chief risk officer, 75% with the chief technology or chief information officer, 60% with the chief information security officer and 58% with the head of human resources.

A core responsibility of every bank board is to provide a credible challenge to the institution's management team. Credible challenge can be defined as a practice where independent directors hold management accountable by asking questions and seeking information to satisfy themselves that the executives are running the enterprise in the best interests of the shareholders.

Almost three quarters of the respondents said they have several directors who are willing to ask tough questions, 19% have at least two such directors, 6% have at least one director who fits that description and just 1% said they have none. Ninety-two percent said their CEO and senior executives are generally open to feedback when the directors pose a credible challenge.

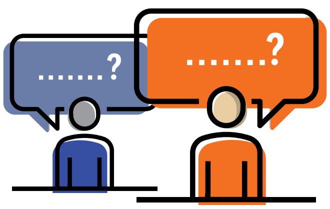
"There needs to be an atmosphere in which credible, well-stated, well-articulated questions and dissent can be voiced without fear of it … being viewed as being outside the norm of behavior in the boardroom," says McAlpin. "How the chair runs the meeting sets the tone for discussion and the atmosphere in the room."

Kayser says City Holding's independent directors are very comfortable with the practice of credible challenge. "We consider that just part of our duty," he says. Many of the questions that the directors ask management are simply to "understand deeper what is behind management's thinking and planning with regard to a particular issue." Kayser says the process is not intended to be adversarial. "There's very good debate about topics, but there's a tremendous amount of respect in the room as well," he says. "It's not adversarial; it's just [the independent directors] doing their job."

At 79%, most of the survey participants said their CEO receives an annual performance review from the board, while 7% said their CEO has been evaluated in the past but not every year. Surprisingly, 15% said they do not review their CEO's performance on a regular basis. The practice is least prevalent at small banks: Only 56% of the survey participants at banks with less than $500 million in assets said they evaluate their CEO annually compared to 94% at banks greater than $10 billion.

At Huntington, the process really begins when CEO Stephen Steinour shares his strategic goals with the board. Then, at the end of the year, Steinour prepares a self-assessment of how he performed against those objectives. "It's one of the most detailed self-assessments I've ever seen, pages long, where he goes through and evaluates his goals, he evaluates the bank and how we did," Porteous says. Porteous also talks with each board member to get their perspective on Steinour's performance, which is followed by an executive session of the independent directors. As the final step, Porteous and the chair of the board's compensation committee review the board's assessment with Steinour. "So we utilize Steve's goals for the previous year, his self-assessment and my individual conversations with the other directors, the collective discussion with the directors, and then we sit down with Steve and review everything."

Does your board have directors who you believe are willing to ask difficult, challenging questions when warranted?



We have several directors willing to ask tough questions

74%

We have at least two such directors

19%

We have at least one director who fits that description

6%

We have no such directors

1%

Does your CEO receive a performance evaluation from the board?

79% 15% 7%

- Our CEO's performance is reviewed annually
- We do not review our CEO's performance on a regular basis
- Our CEO's performance has been reviewed in the past, but not every year

SETTING STRATEGY

A successful strategic planning process requires close collaboration between the bank's management team and board. Just 20% of the survey participants said the board drives the strategic planning process and develops the plan with management; 56% said their board establishes the bank's risk appetite, but management develops the plan. Twenty-two percent said the board approves the strategic plan, but does not play a significant role in developing that plan or establishing the bank's risk appetite, and 2% said the board does not formally approve the plan.

"My view is there's a significant risk if the strategic plan is solely driven by the leadership of the bank or solely driven by the board," says Porteous. "I've seen it done a number of different ways. The one thing I am quite certain about is, it has to be collaborative. I think every bank needs to decide what process works best for them."

Both the senior management team and independent directors are actively engaged in the planning process at Huntington. Porteous says that a group of senior executives are responsible for moving the process forward, and they reach out to every director individually to get their thoughts about what should be included in the plan. "It's not a perfunctory call. It's pretty lengthy to talk about ideas and concepts," he says. "If a bank has a diverse board, you're going to have some pretty strong opinions on the direction the bank should take." Once the framework of a strategic plan is put together, the management team and board spend several days at an annual retreat reviewing the plan and finalizing it.

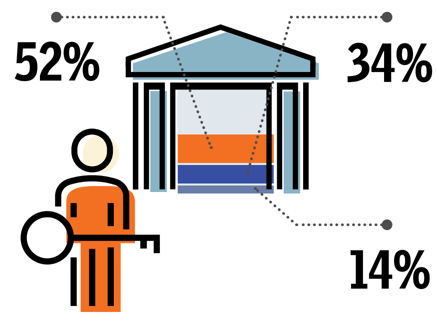
Porteous cautions that every strategic plan should be viewed as a dynamic document that is subject to revision based on market and economic conditions. "The world is changing and is so volatile these days that whatever perfect strategic plan you have, you better be prepared to talk about it almost at every meeting," he says.

City Holding follows a similar process, where the plan "is developed by management with input from the board on issues that it wants to see in the plan," says Kayser. The plan usually looks three to five years ahead, and the board reviews it in detail every year. "But there are times during the year when an issue comes up and we will ask management how this stacks up with our strategic plan," he says. "Is this something that would be a better strategy outside of what we planned to do?"

Seventy-three percent of the survey respondents said their board uses a three-to-five year time horizon for the strategic plan. Seventy-five percent said they review the plan annually, 17% every two to three years and 2% every five years.

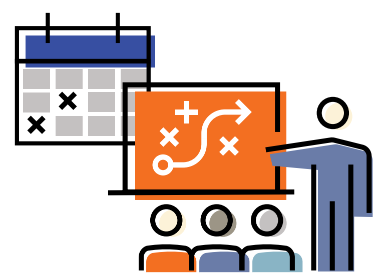
McAlpin, who has facilitated many strategic planning sessions for bank boards over the years, says a frequent shortcoming is that the process isn't strategic enough. "I've been present in many planning sessions in which management has presented what is essentially an operational budget for the next year. This is presented to the board and there is a 'strategic discussion' framed by the proposed budget," he says. McAlpin believes a better approach would be a board-led discussion that focuses on strategic initiatives that would build shareholder value. He offers this example. "A strategic goal would be, 'We want to become the preeminent private bank in Nashville within the next three years.' Then, a more detailed conversation would follow regarding the step-by-step process of achieving that goal. Operational planning follows from strategic goal setting."

Does your board bring in an outside advisor or consultant to assist in developing the strategic plan?



- Yes, but not every year
- No, we do not include outsiders in our strategic planning process
- Yes, every year

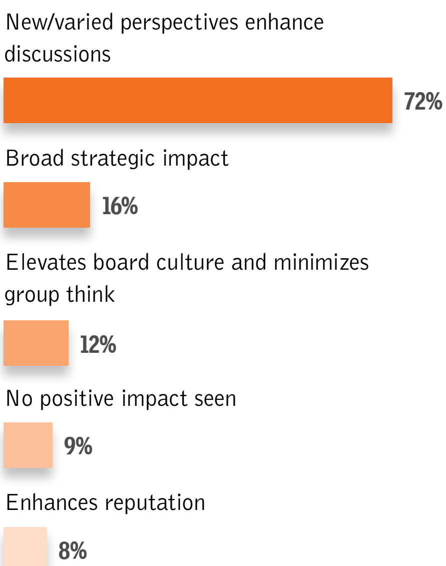
Has your board reviewed the bank's strategic plan in the past six to nine months?



Yes 84%

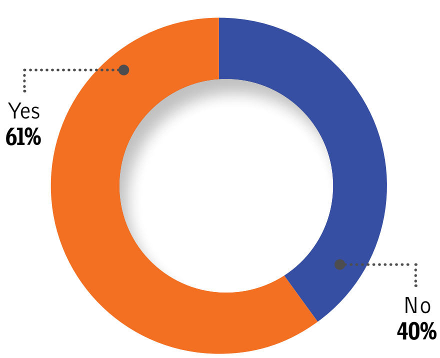
No 16%

How has diversity benefited your board?



Do you believe it's difficult to attract diverse director candidates?

Numbers don't add up to 100% due to rounding.



BOARD REFRESHMENT AND COMPOSITION

Bank boards are overwhelming comprised of graying baby boomers who tend to stick around, as evidenced by this year's survey. Seventy percent of the participants were 61 or older, and the median length of board service was 12 years. Eighty-three percent identified as male and 79% as white.

Fifty-nine percent of the survey respondents said they believe that greater diversity defined by race, gender and ethnicity improves the performance of a corporate board. Thirty-six percent believed that this impact is overrated, and 5% disagreed that diversity improves performance. This is an improvement over last year, when 52% agreed with the statement, 40% agreed only to an extent and 8% disagreed. This year, 65% said their board would benefit from recruiting additional diverse board members. When respondents representing banks with at least one diverse board member were asked how diversity had benefited their board, 72% said it has resulted in new and varied perspectives that enhance deliberations.

Huntington's 18-member board is comprised of 12 men and six women, with four directors being racially or ethnically diverse. Diversity results in "richer discussions" and "fuller and better understandings," says Porteous. "It doesn't mean that decisions will always be right, but I do think it helps assure that the discussion is broad, it's deep and the decision is better understood," he adds.

McAlpin knows firsthand the benefits that gender diversity can have on a board's decision-making process. "I have experienced the power of diversity on a bank board of which I am a member," he says. "We have gone from a board of eight men and one woman three years ago to now a majority female board. There is a difference resulting from that positive transformation. Our board is probably more risk averse than it used to be. We seem to be better prepared as a group for meetings. And as a group we ask more probing questions."

City Holding Co. has two women on its 13-member board, which Kayser says is currently going through a refreshment process as two of its directors are nearing the mandatory retirement age of 75. "Diversity is high on our radar screen at this point," he says. "It's an important issue not just for the company, but for our society. We're going to intentionally look at attracting diverse candidates."

Performance evaluations are one way in which boards can improve their governance processes and hold individual directors accountable. Forty-three percent of the survey participants said they conduct board-level performance assessments annually, while 21% do them less regularly. Thirty-six percent said they do not use performance evaluations.

In addition to assessing the effectiveness of the board as a whole (84%), boards use these performance evaluations to improve governance (60%), identify training needs (59%), assess committee performance (58%), identify underperforming directors (37%) and conduct one-on-one conversations with directors (37%).

An even smaller percentage of respondents said they use peer-to-peer evaluations to assess individual director performance. Just 10% do them annually, and another 14% do them less frequently.

"I think assessments are particularly valuable when there's an identifiable issue on the board," he says. "Whether it's a succession problem or an aberrant director, issues that are difficult to confront or even to raise in the boardroom can be surfaced through a survey. Even well performing boards can benefit from the process."

ROLE OF THE INDEPENDENT DIRECTOR

Engagement and independence are critical attributes of a strong and effective governance culture, and the survey suggests that not all bank boards practice them as much as they should. Ninety-four percent of the respondents said that all their directors attend board and committee meetings, but only 63% said all come prepared to participate, 62% said all review board materials beforehand and just 47% said all members contribute to discussions. Directors generally treat their fellow board members respectfully, but only 71% said all their colleagues exercise independent judgment.

Asked why they serve on a bank board, 70% cited the benefit of professional relationships and growth, 64% mentioned an interest in banking, and 59% said they value the personal relationships and growth opportunities that come from board service.

A bedrock principle in corporate governance is the ability of independent directors to exercise their own judgment free of pressure to conform to a majority view. But sometimes this requires a deft balancing act between the freedom to disagree and collegiality, which is also important. A board in constant turmoil, where there is personal animus between directors, will have a difficult time providing effective oversight. Ninety-one percent said their board values collegiality and the freedom to disagree equally. However, while 72% said they feel free to exercise their independent judgment and dissent if they disagree with a board decision, 28% said they generally feel free to disagree, but their boards have a strong preference for unanimity.

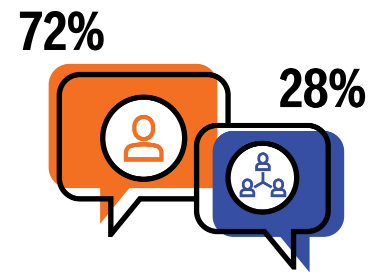
"In our case, debate is really enjoyed," says Kayser of the City Holding board. "We have a collegial group where it's perfectly acceptable to disagree and argue their position. We have split votes. I don't recall one instance where there was a split vote and anyone had hurt feelings. I think everybody considers debate to be part of the job, and part of the job is also being collegial and respecting everyone's opinion."

McAlpin believes that compatibility is an important characteristic of a well-performing board. "That doesn't mean that people don't disagree with one another, but they're compatible; they're respectful of each other," he says. However, directors who have served together for years and may know each other socially and professionally outside the boardroom can end up being too collegial. "Even in a collegial environment, which all boards aspire to, there needs to be an opportunity to challenge each other in a respectful way and walk away friends," McAlpin says.

While corporate governance is a collective enterprise, with a group of people working together for the same purpose, it is deeply influenced by the personal qualities and skills that each individual director brings to the table. There was near consensus, at 99%, that personal integrity was a very important attribute for an independent director. Other attributes that were rated as being very important were the ability to exercise sound judgment (96%), accountability (94%), bringing valuable knowledge or skill sets to the board (83%), working well with others (69%), intellectual curiosity 63%), active engagement in the governance process (61%), and a commitment to ongoing training and education (60%).

Porteous has served on the Huntington board since 2003, and as lead director since 2007. Prior to joining Huntington, he served on the board of a small community bank in western Michigan. "Regardless the size of the bank, the role of the independent director is pretty much the same," he says. "There has to be a level of commitment, and that commitment has to be to your fellow directors. It has to be to the leadership of the organization, it has to be to the shareholders, to the community and to the regulators. If there comes a time when you just can't dedicate that level of commitment, you should probably step down."

Do you feel free to exercise your independent judgment and dissent if you disagree with a board decision?



- Yes, without hesitation
- Generally, although our board has a strong preference for unanimity

Important attributes of an independent director

- Personal integrity
- Ability to exercise sound judgment
- Accountability
- Independent thinker
- Brings valuable knowledge or skills to the board

About the Survey

Bank Director's 2021 Governance Best Practices Survey, sponsored by Bryan Cave Leighton Paisner LLP, surveyed 217 independent directors, chairs and chief executives of U.S. banks below $50 billion in assets. The survey was conducted in February and March 2021, and explores the fundamentals of board performance, including strategic planning, working with the management team and enhancing the board's composition. Fifty-seven percent of respondents represent a bank with more than $1 billion in assets; 71% serve as an independent director, lead director or independent chair.

Questions About Our Research?

Contact Emily McCormick at emccormick@bankdirector.com if you'd like to know more about Bank Director's research initiatives.

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