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Corporate Governance for Banks and Bank Holding Companies

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Agenda

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Key Considerations in Current Economic Environment

Key Considerations in Current Environment

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In responding to the recent bank failures and uncertain economic outlook, financial institutions, and their boards of directors, will be expected to make significant decisions in "real time."

- Boards should continue to actively oversee and monitor the financial institution, including (i) liquidity constraints, (ii) the ongoing rising interest rate environment, (ii) the persistent of inflation in the U.S., and (iii) quantitative tightening of monetary policies by the Federal Reserve.
- Boards may need to convene more frequently through special meetings to receive updates from management—including meetings through telephone.
- Continue to adhere to regular formalities regarding notices, waivers of notice, agendas, pre-meeting board packets, and executive sessions.
- Management should do its best under the circumstances to provide directors with timely and accurate information, even though that may be challenging in some situations.
- Board and committee meetings should be documented through appropriate minutes that help build an evidentiary record that the directors were discharging their duties.

Be aware of heightened regulatory scrutiny:

- **Frequency of Board meetings**
- **Board engagement in decision-making**
- **Oversight of management**
- **Process of risk assessment**
- **Evaluating effects to the institution**

Common Faults in Governing Documents

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COVID-19 exposed many faults in corporate governing documents. Often, these documents are just plain old.

Problems

- Documents are outdated or incorrect.
- Documents are boilerplate.
- Documents don't reflect actual practices of the corporation.
- Inflexible.
- Lack of details on important processes.

Necessary Changes

- Update governing documents to reflect current state law.
- Governing documents should be a roadmap for how your corporation operates.
- Provide greater detail on meetings of board and shareholders.

Common Faults in Governing Documents (cont.)

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Examples of provisions that often need revision.

Lengthy notice required to call a special meeting of the board.

- We frequently see notice requirements for special board meetings as long as *three business days*.
- Instead, shorten notice to provide flexibility to call special board meetings.
- Make it clear in the bylaws that directors can waive proper notice simply by attending.

Date of Annual Meeting of Shareholders.

- We frequently see that annual meetings of shareholders must be held on XYZ date every year.
- Instead, give the board the authority to set the time and date by resolution, providing greater flexibility to corporations in times of shutdowns or restrictions on attendance at meetings.

Description of Officer Positions.

- Ensure they accurately reflect the job responsibilities of those officers and whether officers have sufficient authority to act quickly and decisively when facing problems that may arise.

Common Faults in Governing Documents (cont.)

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Be sure to review the articles and bylaws of ***both*** the bank holding company and the bank.

- Governing documents of both the bank holding company and the bank should reflect your *actual* corporate practices.
- We often see bank holding company governing documents revised while bank governing documents are neglected for years.
- The governing documents of the bank holding company and the bank should be consistent to the extent possible.
- Particular attention should be paid to the applicable state banking code when reviewing bank-level governing documents.
  - Sometimes, a state's banking code may not be completely consistent with that state's corporation code.

"Best Practices"
in Articles of Incorporation and Bylaws
of Financial Institutions

“Best Practices” in Governing Documents

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Overview of Bylaws

- Article I – Offices
- Article II – Shareholder Meetings
- Article III – Board of Directors
- Article IV – Officers
- Article V – Notices
- Article VI – Indemnification
- Article VII – Miscellaneous
- Article VIII – Exclusive Forum

Article II – Shareholder Meetings

Place of Meetings: The Board should have the explicit authority to set the place of shareholder meetings.

Annual Meetings: The Board should have the explicit authority to set the time and date of annual meetings.

Special Meetings: State law often allows the governing documents to specify the requisite percentage of shareholders who may call a special meeting. Boards should consider revising governing documents to state that at least 25% to 35% of the outstanding shares may call a special meeting.

- Governing document should also provide for detailed requirements that shareholders must give to the financial institution if they wish to call a special meeting.

Organization of Meetings: Governing documents should designate a hierarchy of officers who will preside at all shareholders' meetings so there is no ambiguity.

Conduct of Meetings. Governing documents should explicitly give authority to the presiding officer of a shareholder meeting to dictate the conduct, rules, and procedures of a shareholders' meeting.

Article II – Shareholder Meetings (cont.)

Shareholder Proposals at Meetings. Most governing documents are silent on how shareholders should submit requests to present a matter of business at a shareholder meeting.

- Financial institutions should consider including a list of requirements that must be satisfied in order to propose business:
  - Deadline for submission of proposed business.
  - List of information required to be provided, including proof of ownership and whether the shareholder is acting in concert with anyone else.
  - Require shareholders to update any information provided in the proposal before the meeting date.
- Shareholders with advance knowledge of these requirements can simply comply with the provisions.
- Board should have explicit authority to reject proposed business if it fails to comply with the listed requirements.

Article II – Shareholder Meetings (cont.)

Shareholder Nomination of Directors. Most governing documents are silent on how shareholders can nominate individuals to be considered for election to the board.

- Like with shareholder proposals, consider including a list of requirements that must be satisfied in order to propose business:
  - Deadline for submission of nominations.
  - List of information required to be provided, including detailed information about the individual(s) being nominated by the shareholder.
- Provides the financial institution with notice so it may plan a response rather than be caught by surprise.
- Board should have explicit authority to reject a nomination if it fails to comply with the listed requirements.

Article III – Board of Directors

Number of Directors: Specify whether the number of directors may be increased or decreased by resolution of the board—and how to fill those vacancies if seats are added.

Special Meetings: Reduce the requisite notice to call a special meeting of the board of directors.

- Reduce to 24 hours or one calendar day.
- Provide that directors waive the notice requirement if they attend and do not object.

Removal of Directors: State law has default provisions for removal of directors (often for or without cause by majority vote of the shareholders). Some states permit the governing documents to provide for a different voting threshold.

- This will depend on a financial institution's state of incorporation and governing law.
- Will also depend on whether the board is 'classified' or 'staggered.'

Reliance: Explicitly provide that directors may rely on information, opinions, reports, etc. prepared by officers or others believed to be reliable and competent in the matter presented (e.g., accountants, experts, lawyers, etc.).

Article V – Notices

Length of Notice for Shareholder Meetings: Almost every state provides that notice of a shareholder meeting must be given *not less than 10 days nor more than 60 days* prior to the date of the meeting. Governing documents should be updated to reflect this range.

- HOWEVER, many states have different (i.e., narrower) notice standards for significant shareholder meetings (e.g., meetings called to approve a merger transaction).

Electronic Notice to Shareholders and Directors: Many states allow notice of meetings to be given by means of electronic transmission (such as email). If permitted in your state, the Board should consider adding sections to the governing documents allowing shareholders or directors to receive notice by electronic transmission.

- Many states require that shareholders and directors first consent to receiving notice by electronic transmission.
- Shareholders and directors must be allowed to revoke their consent at any time.

Article VI – Indemnification

Provide for Mandatory Indemnification: Many state corporate laws provide that corporations may choose to indemnify directors and officers against litigation expenses.

- Some states allow the governing documents to make indemnification of directors and officers *mandatory*.
- Often, these states also allow governing documents to make advancement of expenses mandatory.
- State corporate laws also allow corporations to purchase D&O insurance.
- Some states allow governing documents to make D&O insurance mandatory.
- Valid business reasons for Board to adopt these requirements.
- Recruiting and retention of high-quality D&Os is in the best interests of the company.

Article VII – Miscellaneous

Amendments to Bylaws: Some state corporate codes allow the governing documents to establish the requisite vote of the Board and/or the shareholders to amend the bylaws.

- Boards should consider allowing the Board to amend the Bylaws by majority vote and the shareholders to amend the Bylaws by at least two-thirds (2/3rds) vote.
- 2/3rds vote of the shareholders is still a meaningful right to override changes made by the Board.

Amendments to Articles: Like with bylaws, some state corporate codes allow the governing documents to establish the requisite vote of the shareholders to amend the articles of incorporation.

- In many states, the default vote of shareholders to amend the articles of incorporation is two-thirds. But in some states, a simple majority of the shareholders can amend the articles.
- Depending on any restrictions in state law, financial institutions should consider increasing the requisite voting requirement for shareholders to amend articles.

"Best Practices" in Governing Documents (cont.)

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Article VIII – Exclusive Forum

Boards should consider adding a new provision to their governing documents that would require certain shareholder litigation be brought in a court in the 'home' court of the financial institution.

- Exclusive forum provisions have developed by companies in response to multiple lawsuits brought in different jurisdictions challenging the same subject matter.
- Most commonly found in mergers & acquisitions context.
- Exclusive forum provisions allow companies to reduce litigation cost.
- Designed to designate a specific 'home' court for litigation related to (i) derivative actions, (ii) actions against directors or officers, (iii) actions arising under the governing documents or governing state corporate law.
- Exclusive forum provisions have been found to be valid in Delaware and a handful of other state courts.

Changes to Enhance Ability to Function Remotely

Functioning Remotely

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Virtual Board Meetings: Financial institution boards of directors must actively oversee and monitor the entity, including the financial institution's response to liquidity issues that mar arise in the current volatile and uncertain economic environment.

Boards of directors should convene more frequently, and one way to do so is by means of remote or electronic communication (e.g., via Skype, Zoom, etc.).

- Governing documents are often silent regarding Board's ability to hold meetings remotely or electronically.
- State law usually, *but not always*, provides the board with this authority.
- Nevertheless, many financial institutions are adding provisions to their bylaws explicitly providing that boards can meet remotely and outlining how directors can receive notice of these meetings (e.g., via email).
- When conducting remote or electronic meetings of the board, state law typically requires that all directors participating must be able to hear everyone else at the meeting.

Functioning Remotely (cont.)

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Examples Found in State Law

Texas Business Organizations Code (Section 6.002 of the TBOC)

- Directors may hold meetings by using a conference telephone or similar communications equipment, including videoconference technology or the Internet, or any combination.
- Each director participating in the meeting must be able to communicate with all other directors participating in the meeting.
- If directors are asked to vote at the meeting, the Company ***must***:
- (1) implement reasonable measures to verify that every director voting at the meeting by means of remote communication is sufficiently identified; and
- (2) keep a record of any vote or other action taken by the directors.

Model Business Corporation Act (Section 8.20 of the MBCA)

- Any or all directors may participate in any meeting of the board through the use of any means of communication by which all directors participating may simultaneously *hear each other* during the meeting.
- However, the articles or bylaws may remove this authority.
- Ambiguities in the MBCA should be addressed in a corporation's governing documents, including:
- (1) whether directors shall have the ability to *communicate* with one another; or
- (2) what steps must be taken by the corporation if directors wish to vote by means of remote communication.

Functioning Remotely (cont.)

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Virtual Board Meetings (cont.): Meetings by means of remote communication are becoming commonplace (thanks to COVID).

- Regulators are meeting virtually with boards and management.

- *Cost-Effective*: Boards regularly meet with attorneys, accountants, IT, etc.
  - Future meetings with legal counsel, for example, may be entirely remote, saving expenses related to travel and unnecessary time billed.

- Bottom line: going forward, all directors need to be comfortable and familiar with board meetings by means of remote communication.

Functioning Remotely

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Board Action Without Meeting/Written Consent: Another alternative for Boards to take action quickly and without calling a formal meeting.

- State law usually, but not always, includes a default that Boards may act without meeting and without notice by unanimously executing a written consent stating the action taken.
- State law usually, but not always, permits the entity's governing documents to reduce this requirement from unanimous to less than unanimous written consent (e.g., majority written consent or 2/3rds written consent).
- Action by written consent adds flexibility and is another way for Boards to function remotely without calling an in-person or electronic meeting.

Consult state law on how directors may "sign" a document

- e.g., wet ink signatures, electronic signatures, email approvals, voicemail approvals, etc.

Virtual or Hybrid Shareholder Meetings

Remote Shareholder Meetings

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Shareholder Meetings: During COVID-19, many financial institution transitioned their annual meetings from in-person shareholder meetings to "virtual" or "hybrid" shareholder meetings. Some have never looked back.

- **"Virtual" shareholder meetings** – held entirely by means of remote communication (e.g., by telephone or video conference) and no in-person, physical meeting is held at all.
- **"Hybrid" shareholder meetings** –an in-person, physical meeting is still technically held and shareholders are given the opportunity to attend by means of remote communication at their option.

Consult state law to determine whether you can hold a "virtual" meeting or a "hybrid" meeting.

- If state law permits, financial institutions need to add or revise provisions in their bylaws outlining the process of conducting a shareholder meeting by means of remote communication.

Remote Shareholder Meetings

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Shareholder Meetings (cont.): Not all state corporation codes are created equal. As of the date of this presentation:

- **36 states** permit both "Virtual" and "Hybrid" shareholder meetings.
  - e.g., Texas, New York, Florida, Michigan, Kentucky.
  - Massachusetts: private corporations may hold "Virtual" or "Hybrid" meetings
- **11 states and the District of Columbia** permit "Hybrid" but do not permit "Virtual" shareholder meetings.
  - e.g., Illinois, Mississippi, Louisiana, Missouri.
  - Massachusetts: public corporations may hold "Hybrid" but not "Virtual" meetings.
- **3 states** do not permit "Virtual" or "Hybrid" shareholder meetings.
  - i.e., Arkansas, New Mexico, and South Carolina.

In response to the COVID-19 pandemic, many states that did not permit "Virtual" shareholder meetings passed emergency legislation or executive orders allowing corporations to conduct their shareholder meetings "virtually."

AT THE VERY LEAST, corporations should consider the benefits of conducting "Hybrid" meetings of shareholders going forward.

Remote Shareholder Meetings (cont.)

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Shareholder Meetings (cont.): Given the experience of our clients during the COVID-19 pandemic, we expect that even more financial institutions will transition to "virtual" or "hybrid" meetings going forward.

To hold meetings by means of remote communication, state law often requires:

- reasonable measures be implemented to verify that each person deemed present and permitted to vote at the meeting by means of remote communication is a shareholder;
- reasonable measures be implemented to provide shareholders a reasonable opportunity to participate in the meeting and to vote on matters submitted to the shareholders, including an opportunity to read or hear the proceedings of the meeting substantially concurrently with such proceedings; and
- if any shareholder votes or takes other action at the meeting by means of remote communication, a record of such vote or other action shall be maintained by the corporation.

Remote Shareholder Meetings (cont.)

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Shareholder Meetings (cont.): Third-party service providers have processes established for verifying the identity of shareholders attending a meeting by means of remote communication and allowing such shareholders to vote by means of remote communication during the annual meeting.

- Third-parties include financial printers or corporate proxy solicitation firms.
- Pros: third-party service providers offer comprehensive services.
- Cons: third-party service providers may be expensive.

Alternatively, financial institutions may instead choose to implement an 'in-house' or 'DIY' process.

- For example, telephonic meetings or meetings hosted on conference platforms like Skype, Zoom, AT&T TeleConference or Cisco Webex.
- If choosing the 'in-house' or 'DIY' alternative, financial institutions should carefully review state law and revise their governing documents to provide for procedures for verifying the identity of shareholders who participate at meetings by means of remote communication and who wish to vote.

Implementing Online Voting for Shareholder Meetings

Online Voting

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Online Voting for Shareholder Meetings: Many financial institution continue to evaluate whether to implement online voting.

- **What is "Online Voting?"** – instead of voting by paper proxy, the shareholder can actually vote online prior to the meeting.
- This is usually accomplished by including unique access credentials (e.g., a unique control ID and passcode) on the proxy materials sent to the shareholder.
- The shareholder will use their unique access credentials to log into a website (typically, it is a link from the financial institution's general website) and vote.

Online voting can be done in conjunction with a physical or virtual shareholders' meeting.

Many financial institutions report that online voting actually increases shareholder participation, so there has been trend for financial institutions moving towards online voting for that sole purpose.

Online Voting (cont.)

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Implementing online voting is fairly straightforward, *but takes time to plan and prepare (often, months)*.

- Obtain Board approval for use of online voting.
- Select a third-party vendor to assist with the online voting platform and hosting.
  - Ensure sufficient time is allotted for diligence in selecting a vendor.
  - Legal counsel should review any contract with a third-party vendor to ensure the terms are fair.
- Set up online voting platform and determine proposals to be considered at such meeting, which involves meetings with the vendor, management, IT, etc.
- Test the platform well before the proxy materials for the shareholder meeting are mailed out.
- **Now is the time to start**. Corporations need to begin working on these items in the fourth quarter of 2022 in anticipation of the 2023 annual meeting season.

Electronic Delivery of Shareholder Meeting Materials

Electronic Delivery of Meeting Materials

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Electronic Delivery of Shareholder Meeting Materials: Most state corporation codes permit electronic delivery of documents in connection with a shareholders' meeting (e.g., notice of the meeting, proxy statement, proxy card, etc.).

- However, state law generally requires that corporations obtain the prior written consent of the shareholder.
- If a financial institution has hundreds of shareholders, then collecting these written consents can take time.

During COVID-19, many financial institutions did not have the written shareholder consents and thus, they could not utilize electronic delivery of the shareholder meeting materials.

Electronic Delivery of Meeting Materials (cont.)

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Examples Found in State Law

Texas Business Organizations Code (Section 21.3531 of the TBOC)

- On consent of a shareholder, notice from a corporation may be provided to the shareholder by electronic transmission.
- The shareholder may specify the form of electronic transmission to be used to communicate notice.
- A shareholder may revoke his or her consent to receive notice by electronic transmission at any time by providing written notice to the corporation.
- Consent is *automatically* considered revoked if the corporation is unable to deliver by electronic transmission two consecutive notices, and the person responsible for delivering notice on behalf of the corporation, knows that delivery of those two electronic transmissions was unsuccessful.

Model Business Corporation Act (Section 1.41 of the MBCA)

- A notice or other communications may be delivered by electronic transmission if consented to by the recipient.
- Any consent may be revoked by the person who consented by written or electronic notice to the person to whom the consent was delivered.
- Any such consent is automatically considered revoked if (i) the corporation is unable to deliver two consecutive electronic transmissions given by the corporation in accordance with such consent, and (ii) such inability becomes known to the person responsible for the giving of notice or other communications.

Electronic Delivery of Meeting Materials (cont.)

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Advantages of electronic delivery of shareholder meeting materials:

- Generally a more cost effective way to deliver materials, as the cost for printing, mailing, and shipping materials can be expensive, especially for financial institutions with larger shareholder bases.
- Generally a faster way to deliver materials, as delivery is immediate instead of waiting for physical delivery by a postal carrier.
- Delivery is more accurate, as long as the corporation has a current email address, as there are not issues with materials being lost or delivered to old addresses.
  - *However*, be careful about materials being trapped in the spam box.
- Electronic delivery is more hygienic, as there are no issues with individuals (e.g., financial institution employees, document preparation teams, postal carriers, etc.) touching the paper which is ultimately delivered to shareholders.

Again, it can take a while to obtain written consents from shareholders who wish to receive electronic delivery of meeting materials. We recommend beginning this process well before you begin preparing for your next annual meeting of shareholders.

Questions?

Speaker Information

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•EDUCATION

•JD, Duke University School of Law, 2016
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•BAR ADMISSIONS

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Nate's practice focuses on transactional, securities, and corporate governance matters involving banks, bank holding companies, and other financial institutions.

Nate advises financial institutions and their holding companies in a wide range of corporate and regulatory matters, including corporate governance matters, securities offerings, mergers and acquisitions, and general bank regulatory matters.

Nate also represents issuers and underwriters in initial public offerings, follow-on public offerings, shelf registration statements, and private placements. His practice includes regularly advising SEC reporting companies, as well as companies with securities quoted on the OTC Markets Group, regarding compliance with ongoing reporting and disclosure obligations under federal and state securities laws, securities exchange and OTC listing requirements, and other federal and state laws.

Nate has also been a speaker or presenter at numerous banking events, including events sponsored by the Texas Bankers Association and the Independent Community Bankers of America.

Relevant Experience

- Represents banks and bank holding companies in all matters related to mergers and acquisitions, mergers of equals, and branch establishments, sales and purchases.
- Advises public company clients on federal securities law matters, including compliance with periodic and ongoing and periodic disclosure obligations of SEC reporting companies.
- Advises public and private company clients on debt and equity offerings as well as federal and state securities law compliance.
- Advises boards of directors on corporate governance matters, including fiduciary duties, strategic planning designed to enhance or protect shareholder value, developing and implementing corporate responses to activist investors, and ongoing counsel related to corporate governance efficiencies.
- Represents banks through regulatory applications and capital raising matters for the establishment of de novo bank charters, bank charter conversions, and bank holding company formations.

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