Breakout 3:

Risky Business: Navigating Board Risk Oversight

Seth Winter
Troutman Pepper Hamilton Sanders LLP

George Makris
Simmons Bank

BankDirector.
#BBTF24

Risky Business: Navigating Board Risk Oversight

September 16, 2024

Bank Director
2024 Bank Board Training Forum

troutman pepper

Speaker Profile

Seth A. Winter
Partner
seth.winter@troutman.com

Seth represents publicly traded companies and financial institutions, including banks and bank holding companies, nonbank lenders, and other fintech and financial services companies, on regulatory, compliance, strategic, corporate law, securities law, and disclosure matters.

Seth regularly represents financial institutions in mergers and acquisitions, including bank mergers and acquisitions of nonbank institutions. Seth also represents financial institutions in connection with applications to federal and state regulatory agencies, including applications related to organic and M&A growth, new lines of business, and strategic equity investments.

Speaker Profile

George A. Makris, III
Executive Vice President,
General Counsel

George serves as Executive Vice President, General Counsel, and Corporate Secretary for Simmons First National Corporation and Simmons Bank.

Prior to joining Simmons Bank, George served as an attorney on the Staff of the Securities and Exchange Commission, and practiced securities regulation at a large international law firm.

Disclaimers

These materials and commentary are intended for educational purposes only.

No portion of these materials may be construed as rendering legal advice for specific cases, or as creating an attorney-client relationship.

The opinions expressed herein and at the presentation are solely those of the authors/speakers and not their respective firms or companies.

troutman pepper

Agenda

Risk Oversight is a Key Aspect of a Director's Fiduciary Duties

- *Caremark* claims
- Risk oversight v. risk management

Regulatory Expectations re: Risk Governance Framework

- Traits of effective risk management systems
- Evolution of your Bank's risk governance

Risk Oversight in a Consolidating Industry

- Managing acquired risks
- Developing risk oversight expertise

Risk Oversight is a Key Aspect of a Director's Fiduciary Duties

Basic fiduciary duties of bank directors:

- *Duty of Care* – requires informed, deliberative decision-making based on all material information reasonably available
- *Duty of Loyalty* – requires acting, or deciding not to act, in good faith and on a disinterested and independent basis. Requires an honest belief that the action is in the best interests of the company and its shareholders.

Many jurisdictions include a "<u>Duty of Oversight</u>" within the broader duty of loyalty.

troutman pepper

Risk Oversight is a Key Aspect of a Director's Fiduciary Duties

The *Caremark* case explains the Duty of Oversight, in the context of a company's failure to comply with legal requirements.

- Directors breach the duty of oversight and can be liable if:
  - Sustained or systematic failure of the Board to exercise oversight over "mission critical" risks, such as failure to establish a reasonable information / reporting system
  - Deliberate failure of the Board to monitor an information / reporting system, resulting in disregard of specific "red flags"

The legal threshold for director liability is high.

troutman pepper

Risk Oversight is a Key Aspect of a Director's Fiduciary Duties

Recently, courts have allowed shareholder plaintiffs to proceed to discovery on *Caremark* claims, and survive motions to dismiss, when:

- History of unaddressed deficiencies
- Failure by the company to provide Board minutes that document active Board supervision of compliance and risk assessment functions
- Board inattention conflicts with Board-level or company-wide policies

Many companies settle fiduciary duty litigation after claims survive a motion to dismiss, to avoid significant litigation costs and ongoing negative publicity.

Risk Oversight is a Key Aspect of a Director's Fiduciary Duties

The Boeing Company recently settled *Caremark* claims for $225+ million.

Home | About | Explore Topics | Vendor News | Events | Library | Podcasts | Videos | Jobs | Subscribe

Home > Governance

A Lapse in Safety Can Lead to Lawsuits for Directors and Officers. Boeing's Board Learned That Firsthand.

Boeing's Board of Directors Settled a Caremark Claim Lawsuit with Shareholders for $225 Million Over the Crash of Two 737 Max Jetliners

troutman pepper

Risk Oversight is a Key Aspect of a Director's Fiduciary Duties

Risk Oversight is very different from Risk Management.

- The Board is not responsible for day-to-day management of risks.

How does an effective Board separate risk oversight from risk management?

- Rely on management to implement the Board's direction and manage related risks.
- Require robust reporting by management to the Board.
- Identify specific instances when additional Board risk oversight is valuable
  - Oversight of risks within a Committee's topical expertise (ALCO, Audit)
  - Establish separate Risk Committee to integrate with ERM function

Risk Oversight is a Key Aspect of a Director's Fiduciary Duties

What is the right scope of information to provide to the Board?

- When making a decision, no director should think "I wish I had more / different / better information."
- More information does not guarantee better decision-making.
- Remember – directors are not expected to be the day-to-day risk expert.

Directors should coordinate requests for additional information through the executive management team.

Agenda

Risk Oversight is a Key Aspect of a Director's Fiduciary Duties

- *Caremark* claims
- Risk oversight v. risk management

Regulatory Expectations re: Risk Governance Framework

- Traits of effective risk management systems
- Evolution of your Bank's risk governance

Risk Oversight in a Consolidating Industry

- Managing acquired risks
- Developing risk oversight expertise

Regulatory Expectations re: Risk Governance Framework

Banking regulators are clear – part of a Board's oversight responsibility is confirming that the bank's risk management system effectively:

- Identifies risk
- Measures or otherwise quantifies risk
- Monitors risk
- Controls risk

Failure of a risk management system on any of the above is an unsafe / unsound banking practice.

troutman pepper

Regulatory Expectations re: Risk Governance Framework

A bank's risk management system must specifically address these risks:

- Credit
- Market / interest rate
- Liquidity
- Operational / vendor
- Cybersecurity
- Compliance
- Legal
- Strategic

Regulatory Expectations re: Risk Governance Framework

Bank boards must require that management set the appropriate tone at the top.

Otherwise…

troutman pepper

Regulatory Expectations re: Risk Governance Framework

Regulators expect your bank's risk management systems to evolve with your bank.

High-performing banks:

- Work cooperatively with regulators to adjust risk frameworks and systems as the bank grows
- Understand the value of investments in effective risk systems
- Commit to establishing key risk indicators (*KRIs*) and key performance indicators (*KPIs*)
- Use KPIs and KRIs to measure performance and summarize available data

troutman pepper

Regulatory Expectations re: Risk Governance Framework

Bank Boards should encourage investments in risk systems that improve the bank's ability to quickly gather and summarize data.

- Centralized data v. distributed data
- Integration with core processing platform
- Effective use of vendors, incl. fintech and reg-tech
- Expect continuous adaptation and improvement

Give feedback on risk summaries prepared for the Board!

troutman pepper

Agenda

Risk Oversight is a Key Aspect of a Director's Fiduciary Duties

- *Caremark* claims
- Risk oversight v. risk management

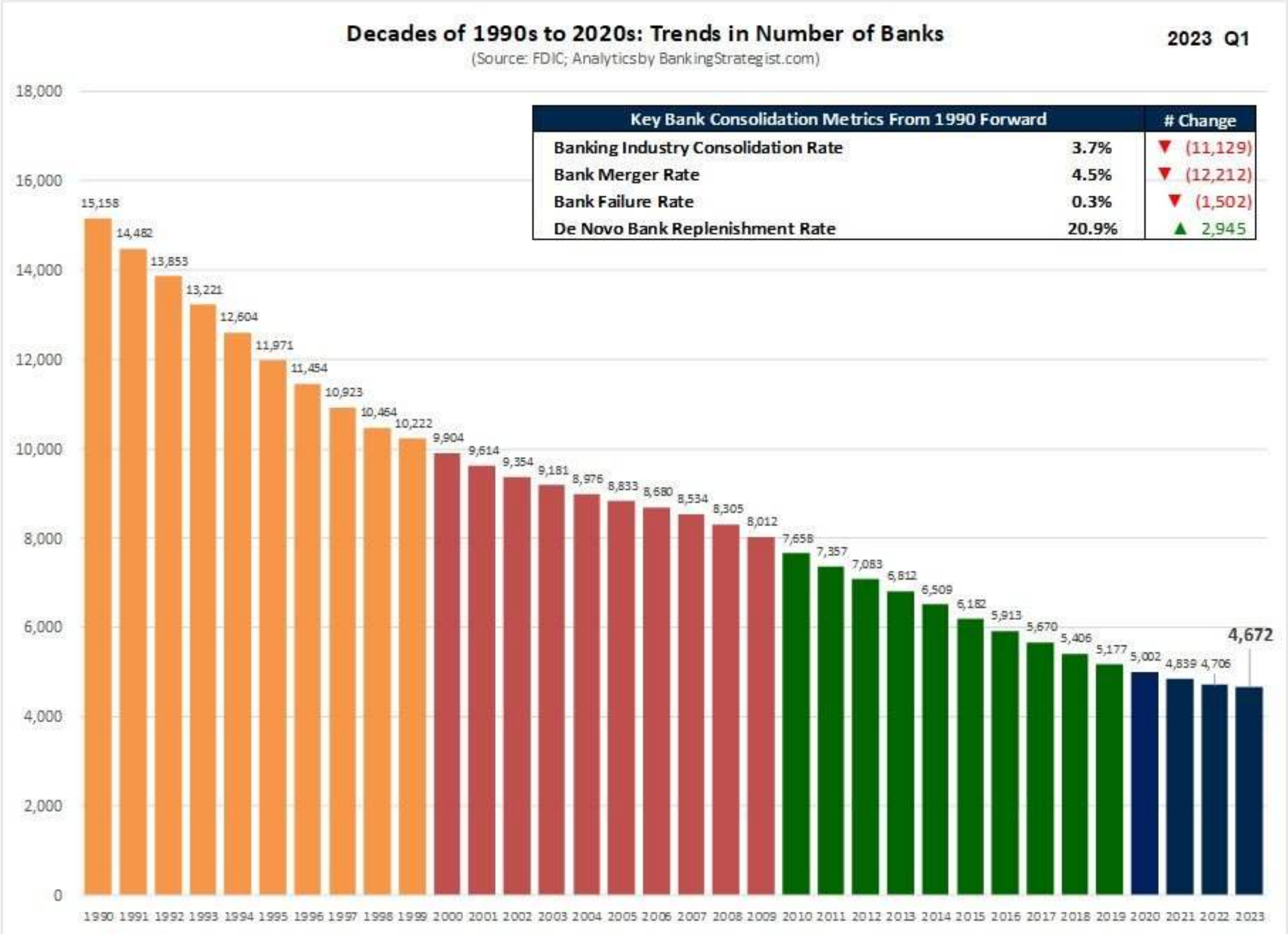
Regulatory Expectations re: Risk Governance Framework

- Traits of effective risk management systems
- Evolution of your Bank's risk governance

Risk Oversight in a Consolidating Industry

- Managing acquired risks
- Developing risk oversight expertise

Risk Oversight in a Consolidating Industry



Source: BankingStrategist.com

Consolidation via M&A activity introduces new, extrinsic risks to growing banks.

Managing these risks requires slightly different tools and skill sets from Boards and management teams.

troutman pepper

Risk Oversight in a Consolidating Industry

Effective oversight and management of "acquired risks" is achieved by:

- Board oversight of management's diligence process and findings
- Capitalizing on acquired institutional knowledge in closing/integration processes
- Board support for management "dry runs"
  - *Practice makes better (not perfect)*
  - *Boards learn more with each management report about a possible strategic transaction*

Deliberate practice builds expertise.

troutman pepper

Risk Oversight in a Consolidating Industry

Best practices:

- Effective use of M&A playbook
- Management reporting, and Board questions, should be reinforcing feedback loops
- Maintain broad perspective on risk, and monitor for emerging risks

Remember, risks can significantly change during the course of a project.

troutman pepper

September 16, 2024

Bank Director
2024 Bank Board Training Forum

troutman pepper