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Credit Risk Ready Podcast

Host Linda Keith CPA With Kevin Smith

Director Duty of Care in a Major Credit Disruption

Linda Keith:
Hi, this is Linda Keith CPA with Credit Risk Ready, a podcast where we interview senior credit and lending professionals from community financial institutions across the United States, their regulators, and banking advisors to better understand and mitigate credit risk.

In this episode, Kevin Smith of TEAM Resources walks us through the steps a director must take to step up to their duty of care. The risk profile may be changing rapidly. As a director, you may have a need for more information that is digestible and tailored to your needs. You may need to include information from outside your normal channels.

Kevin Smith is a consultant and publisher with TEAM Resources, deeply involved in training, designing, and implementing professional development resources to nourish the growth of leaders in the financial institutions industry. Kevin gets into the trenches, facilitates strategic planning, teaches strategic governance to boards of directors, and oversees the TEAM Resources board self-evaluation programs.

Welcome back, Kevin.

Kevin Smith:
Thanks again for having me.

Linda Keith:
So, Kevin, I've always felt that the duty of care is a personal duty and responsibility. But I sometimes find that directors of financial institutions expect that the CEO or the chair of the board knows what their duty of care is and will provide whatever information and training they need to achieve it. So how personal is this duty of care?

Kevin Smith:
Oh, it's the individual director. And it's so easy, because we speak about the board of directors. It's a group, right? So we're working together to make group decisions. But when you sign on to the board,

you sign an oath of office and the duty of care requires that you take the responsibility for the work. Now, that usually means delegating, and you can delegate all sorts of operational authority, but you cannot delegate the responsibility. That's what the duty of care means. It is not the board's duty of care as a group. Each individual has to sign on to that.

And to your point: your example is that it's easy for us as board members to think we're all sharing that and it can get lax. Whereas individuals, if you don't see your colleagues stepping up, it's still your responsibility to ask the right questions, to dig in deeper. You can't simply get complacent because that's the sort of culture of your organization. That's not going to hold up.

The worst-case scenario of this… I have to remind people… is that you, as individual board members, can get sued for this if you're not pulling your weight. If you're not up to that standard. That's an awful, extreme example. I hate to go to doom and gloom and use the word "sue" and "lawsuit" right away, but let's be frank about what's at stake here. When we jump into a crisis environment, like we have a pandemic environment, it's all the more reason that directors consider what their duty of care is and step this up to a higher level.

Linda Keith:
Well, I've seen two different ways that I believe directors can accidentally become complacent. Because I don't actually think any directors, well, maybe some directors, get on to put it on their resume. That's certainly possible. But I think most the time once they're there, they do intend to serve.

Kevin Smith:
That's usually the case, right.

Linda Keith:
Yeah. So, there's two things I see. One is, "Gosh, there's somebody on the board who's really good at this, so I'll let them run with that part of it." Whether it's somebody who's really good at understanding finances, or some piece of it, that you defer to them. And I don't have any problem with different directors having different strengths. But just because somebody else is good at it, doesn't mean you actually then can simply delegate your duty to them and sit back during those parts of the board meeting and figure, "Well, I don't really need to understand it, because Joe understands it."

Kevin Smith:
That's right. You can't coast because somebody else is taking on that part. This is where the board shares all of that and works together. But the way you put that is spot on. You can't defer because somebody else has got that strength. You're still on the hook and now is a time for directors to pay very close attention to that. So that they're asking the right questions. That they're getting the right information that they need.

We want to caution board members from taking this crisis to mean that they're jumping into the weeds of operations. No, we don't need to you do that. But we need to make sure that you are understanding the risk profile of your organization, because that has likely changed in the last few months.

Linda Keith:
Yeah, I can imagine that if a board of a financial institution has not had a conversation about our changing risk profile in the last six months, I don't know what they've been doing.

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Kevin Smith:
That's right. But are they understanding it at the proper level? And are they having a conversation deeper than, “Has it changed?” “Yes, it's gotten worse.” “Okay.” So are they digging into the detail and understanding at the right level, without overstepping their boundaries, and trying to get into the operations? This is a tricky tightrope to navigate.

Linda Keith:
Right. Well, and I can imagine then that if a listener is a director who recognizes in themselves that maybe they've been in this space where they haven't been the one that really understood something, they let somebody else do it, or even the other place… I see this, actually… is a director comes on who's new and thinks that the best thing they can do is sit back and pay attention for a year or so while they get their feet under themselves. That's actually not a good idea, even in good times. It is a terrible idea.

Now, nobody gets to wait to figure this out, unfortunately, and it's not our fault. But we're in a pandemic recession. And our financial institution is probably challenged. Maybe capital is still good, maybe liquidity is still good. But the whole issue of the uncertainty of this recession. How is it going to affect our communities? How is it going to affect our credit union members? Our business banking borrowers? We don't know. There's too much uncertainty.

So even if your financial institution is good right now, some of the things that I'll bet you, the CEO is doing and the board should be aware of are things like stress testing ourselves. What will happen if a certain percentage of our loans go down? What level would we not be meeting our capital requirements? That's all operational. But it's the responsibility of the board, I would think, to know that the CEO is thinking that way. Is that right?

Kevin Smith:
That's right. What are we doing during this pandemic to understand how we're going to get through it? And in good times, there’s levels of information that can be easily read on dashboards and you have a sense of what's going on. But right now, understanding this is going to need a different level of detail and making sure that the board understands what's happening here.

I love that you brought up the rookie board member who doesn't have a lot of experience. We deal with this a lot. When I asked veteran board members how long it took for them to know enough to be comfortable and asking questions, and that is usually measured in years, sometimes it's four or five years. That's really distressing. But what I like to tell those rookie board members is, “Now is your chance. Don't wait until groupthink can get a hold of you. Play the rookie card for as long as you can and ask every question that occurs to you. Because your colleagues might be thinking, “Well, I can't ask that. I'm going to look like I don't know what I'm talking about.” No, play that rookie card and ask that question. Don't wait until you're comfortable. Jump in with those questions now, because you have that rookie insight. That outsider's perspective that is really valuable in any time, but particularly now in a crisis mode where you could be asking questions people haven't thought of. Because they're used to the system.” Right?

Linda Keith:
Yep, that's right. The rookie questions might be the perfect questions right now.

Kevin Smith:
That's right. And there's a governance book out there that I really like. It's called *Governance as Leadership* by Richard Chait, William Kennedy, and Barbara Taylor. I've learned a lot from that. One of the perspectives that they give is the value of leading from the edge. This is from a director's perspective. How you can govern in a way that is beneficial to the organization and to the CEO, is that as a director, you're not down in the trenches. So, you're never going to understand that level of detail. Nor do we want you to. But you're not also a complete outsider. You know something about the organization. So as a director, you're sort of walking this circle right at the perimeter of what's going on. And that's a different perspective. That's valuable for the CEO and staff that are down in the trenches.

Using that idea of governance as leadership and leading from the edge by asking questions from that periphery, you can support the organization. That is really a good part of your duty of care to ask those probing questions. To make sure that everything is going the best it can be, particularly when we're talking about running from fire to fire. That can be one of those ways that you really support your CEO and your team below.

Linda Keith:
Right. We do have the link to that book in the show notes if people want to get that.

I know that when I was director, I was looking for good governance books, because again, I was a business owner. I'm good at that. I'm the president of my company, right? So, I know how to get stuff done. I know strategy, I know tactics, and so forth. And so very different responsibility and approach. I know that when I first joined my first board, I was like a bull in a china shop. I did not know what I was doing and I kept getting operational tactical, because that's what I was used to, right? And it really took the chair of the board, and some of my other directors, and the CEO to continually notice what I was doing and help me make that shift. I was willing to do it, I just didn't know I needed to. I didn't know I needed to. I figured they had… And in this particular case, this organization had had some financial challenges. I'm a CPA. I understand finances. So I came in on my white horse. Well, should have left the white horse behind. Not that I didn't bring all my skills and talents and all that was important, but I wasn't there to take over the financial stuff. I was there to be a director. And it's just different.

Kevin Smith:
And that is the challenge for board members. You get recruited often because you're good at what you do in your day job. But what you do in your day job is operational. And that's how you know you get stuff done. So, it can be tricky. As a board member, you don't necessarily know how you're adding value, because you're learning how to stay at that strategic level when what you want to do is get down there and get your hands dirty. And that's what's familiar and that's how you know you've made a difference.

Linda Keith:
You want to fix it.

Kevin Smith:
Yeah, you want to fix it. Right? And that is not your job as a director, right? It's setting the mission, the vision, and the values here. So understanding what duty of care means in good times, and now in stress times, it's different. Understanding that perspective can be challenging, but we need to pay attention to it.

Linda Keith:
Right. Well, in the board I was on, we had a phrase called "into the weeds," because we all helped each other. We all helped each other. We'd have a conversation and finally someone somewhere along the way would say, "I think we're getting into the weeds." It wasn't an accusation. It wasn't a negative statement. It was almost a temperature check. "I think we're getting into the weeds." The rest of us would go, "Oh, you're right." And we'd pull back up to strategy. Or, on very rare occasions, especially in a crisis situation, we might say, "It feels a little into the weeds, but because of x, I still think it's an appropriate conversation," or something. It just let us stop and say, "Are we in the right place right now?"

Kevin Smith:
You're doing a litmus test mid-conversation there. And that is a really good point during crisis. Sometimes you need to assign that to somebody, because you're not all going to remember to do that. Maybe at the beginning of the meeting, you assign somebody to be the devil's advocate and say, "Alright, pay attention to our conversation. When we start getting in the weeds, let's do a temperature check. We're in the weeds, but is that okay? Because…" But you need to continually reflect on that.

The challenge is you get your board training regularly and you're continually warned against doing that. That becomes your groove, your lane, right? Well, I can't do that. Well, everything's different now. Everything's different. So, are you paying attention? Are you being self-reflective as an individual director? Are you bringing this up to your group, to your seven-to-nine people, or your nine or eleven people, and saying, "Are we paying attention to where those lines are right now?"

It kind of sounds funny, but this needs to be an overt conversation. It needs to be intentional right now. Yet, it's too easy to take it for granted that everybody knows that this is what's happening. That the lines are changing. No, no, no, don't do that. Be the director that speaks up and says, "Are we paying attention to the lines? Are they in the right place?"

Linda Keith:
Now, can it happen, Kevin, in reverse? I remember at one point, I kind of thought our CEO was giving us too detailed information. It was almost like the CEO was taking us into the woods. Maybe because he felt that right now we're in a difficult time so they need more information. We were getting detailed stuff to look at board meetings. I'm the financial person. I thought, "Oh, well, if the CEO is giving it to us, it must be because we should really look at it." I spent all this time. And finally, frankly, I let the CEO know. And then everybody else on the board was relying on me to do it, because it happened to be my expertise. Right? In our case, it was looking at our budget. I was on the board during the recession. So, '08 through '14, so it was an association. It was a time where there were some real financial challenges. I thought I was stepping up and doing the right thing. And finally, I realized, reading some of my books and reading blogs like yours, and so forth, I thought, you know what, this is not my role to look deeply at these numbers.

Kevin Smith:
That's right. And we expect the CEO to know exactly where these lines are, too. We as board members have each other as board members to count on to keep us in line. And sometimes the CEO is doing a bit of leadership and going it alone. They're not always clear about what's helpful. And what's the easiest thing to do? Just throw the whole kitchen sink in there.

Linda Keith:
Exactly. I'll give you a 20-page report, because then I know I will have done my responsibility to inform the board.

Kevin Smith:
It's covered, right? It's covered if it's in there, but it may not be helpful. So, there's some negotiating going on there. We, as board members, particularly if we've got a really great trusting relationship with the CEO, it can be really easy to just defer and say, “Well, she knows what she's doing here. She must be giving it to us for a reason.”

Linda Keith:
Right. Which means I should be doing something with it because I'm a diligent director, so now I spend time on something because of that misinformation.

Well, you know what’s interesting? I’m keying in on a couple things that I believe lands squarely with the chair. And one of those is to be sure that the directors have had a conversation about, “Is the level of information we're getting sufficient? Is it too much? What's happening when you get these reports? How much time are you spending in the weeds?”

And then, from that conversation, have that negotiation that you're talking about with the CEO that says, “You know what? It will really help us if instead you give us a high level. And if we want the reports, we'll get them from you. But here are the things we're pulling out, and maybe if we don't get quite so much information.” And then the other one is the chair can independently assess the abilities of the various directors and realize, “We're counting on Joe too much on the financial piece. Maybe I could ask Joe at one of our meetings to do a quick little training for the rest of us on just the high-level pieces that he thinks we all should understand.” So that we start supporting the individual directors to build their ability to do their own duty of care and then also not overwhelm them with things that we're getting that's really just too much.

Kevin Smith:
It's interesting that you bring this up because I've got a planning session with a board coming up in a couple of weeks. One of the things that they asked me to do was to look at their board portal, and the information that they push out for the board meeting, and help them negotiate what they need. Are they getting things at the right level? It’s a discussion between the board and the CEO. The CEO wants to give them everything that they need and the board wants to have everything that they need, but nobody wants to step on anybody else's toes. It's out of a great level of respect.

But they want somebody to look at this from the outside and say, “How do we negotiate this information and make best use of the time?” So they're asking me to help guide that. Sometimes you need an outsider's set of eyes to figure out what's really valuable. Team Resources: we really like the use of dashboards. That dashboard will have a minimum level, and maximum level, and a target level in between. We're always looking at ratios and numbers.

Linda Keith:
Yeah. I bet you have colors on your dashboard, too, don't you?

Kevin Smith:
Yes, of course! Of course!

Linda Keith:
Like there's the whole green, yellow, red. So, it's visually super easy for a director to zero-in on, "Here's something I need to look at, understand better, get more information, or ask questions about."

Kevin Smith:
That's right. So you can look at trend lines. "Is it staying in the safe zone? Is it approaching the top level? The bottom level? Are we close to on target?" If that's the case, then we don't have to deal with that anymore. We don't have to get into the weeds anymore.

The other piece of this that you brought up there was the fact that directors need a lot of education. Where does that typically happen? Too often, it's happening only in the board meeting in the boardroom. So, suddenly, the CFO or the CEO is providing 15-to-20 minutes of education in the boardroom. But it's taking up board meeting time. The education is valuable, so long as it's not eating in the time that should be focused on strategy or risk changes. Sometimes it's appropriate to take some other time to schedule that education. Maybe it shouldn't be the CFO or the CEO, despite their expertise, because it just muddies that water there. The importance of director education cannot be overstated. But be careful about how and when you're doing that so it's not muddying the water. Because the CEO and the staff, they want nothing more than to make sure that the board is taken care of. That can just be a cause for some confusion. The board chair… You are absolutely right, the board chair can help clarify those zones to make sure that you're teeing up the right conversation and making sure that nobody's overstepping those boundaries that are negotiated.

Linda Keith:
The other challenge here is the CEO and the CFO both. It's not that they don't understand this really well. But, Kevin, you and I are in training development. And what we know is just because you understand, it doesn't mean you're the best at explaining it or creating some kind of an instructional something.

I've got a new client coming on board to our lenders online training for loan origination. One of the things he said is, "You know, we've got some pretty green people that have just come on. And we've talked about doing this training internally. But we think that the time it would take to develop something that would really be on target would take us away from what we need to be spending time on and probably wouldn't be as good as somebody who's actually developed something with adult learning instructional design, those sorts of pieces." And so that's the same thing for our directors if we can find and, by we, I mean, you know, the global we, but if the chair, or people in the board who have found a resource that is external, not only is it possibly simply a better way to explain things, because it's designed that way. But we've talked about this in another episode. Having other resources for information than simply your management, your CEO, your CFO, shows regulators that you are making decisions that are based on a broader set of information than only the information that you get from management.

Kevin Smith:
That is straight out of my board governance training deck.

Linda Keith:
Oh, there you go.

Kevin Smith:
A variety of feedback mechanisms that don't all have the CEO's fingerprints all over them. Now, I want to give all credit to every CEO out there, but I've read too many news stories that involve finagling of information. And the board says, "Well, we didn't know anything about that." And the reason is that they've only seen information that's had the CEO's fingerprints on it. They never choreographed that information or aligned that information with an outside source. That's part of that duty of care: knowing that this information is reliable and finding those other sources of information.

Linda Keith:
Well, and the directors don't work for the CEO. Right? Right. Directors work for the members in a credit union. They work for the shareholders in a bank. And truly, since these community financial institutions are the bedrock of the economic health of a community.

Right now, in the pandemic recession, which for those of you listening later, it is the end of September. We're six-plus months in. We've got COVID still out of control. We have places that are opened and are closing again. We have businesses that made it this far, but probably aren't going to make it. We have families who did have extended federal unemployment that that's going away. We have other families who managed to keep their jobs. They could work from home, and they actually are accumulating savings, and paying down debt, because they're not spending the money they normally spend. And we actually have even more income initially, because sometimes the unemployment was actually as much, but maybe even more, than the job you lost.

So, we are in extreme uncertainty. We are right at the edge of maybe getting a vaccine approved, but probably at least six months away from use nationwide in the United States. So we are in a lot of uncertainty. And our directors are responsible to their financial institution, which is part of what's keeping our communities whole. Directors have a lot, a lot, a lot on your shoulders right now. And being able to better understand, "Did my duty of care just change? Because this isn't what I signed up for." Well, I'm sorry, this is what you signed up for. This is the time.

Kevin Smith:
This is what you signed up for. This is good times and bad times.

Linda Keith:
It is. So, in this session, thank you, Kevin, for helping us talk about some of the ways that the individual director, and the chair of the board of directors, and the CEO can relook at that. And where that individual director can understand about the importance of asking questions. Not stepping aside because you're the rookie, or you're not the expert, but saying, "You know what, I need to not step aside, I need to step up now. And here are some of the ways we do it."

I highly recommend Kevin's book that he recommended in the show notes. I'm also putting in the show notes a module I created for directors. It's called Camels for Directors. But it's not just about how regulators use that structure. It's a way to use that structure to make some of the big decisions that you have made in the past but now need to perhaps remake in the circumstances we are in.

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So, Kevin, thank you so much for helping us with how to be a better director and help our financial institution and our community through this challenging time.

Kevin Smith:
It's my pleasure. Thank you for having me. I'd love to be able to help however I can.

Linda Keith:
Fantastic. Thank you.

Linda Keith:
Thanks for joining us on the Credit Risk Ready podcast. Subscribe, comment, or share on social media to stay connected and spread the word. Join me next time as we bring our bank, our customers, and our communities through the recession safe and sound.

Take care.

Resources

- *The TEAM Resources Guide to Strategic Governance*: https://forteamresources.com/products/books/
- *Governance as Leadership: Reframing the Work of Nonprofit Boards:* https://boardsource.org/product/governance-leadership-reframing-work-nonprofit-boards/
- TEAM Resources Blog: https://forteamresources.com/tims-blog/
- CAMELS for Directors: How to Use CAMELS for Decision-making: https://www.lendersonlinetraining.com//wp-content/NQ/OTHER/CAMELS%20for%20Directors/presentation_html5.html
- 10 Critical Elements of a Board’s Role in Crisis Management: https://lindakeithcpa.com/wp-content/uploads/2020/11/10-Critical-Elements-of-a-Board.pdf

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About Kevin Smith

Kevin Smith is a Consultant and Publisher with TEAM Resources. He brings extensive experience in training, designing, and implementing professional development resources to nourish the growth of leaders within the credit union industry. Kevin facilitates strategic planning processes, teaches strategic governance to boards of directors, and oversees the TEAM Resources board self-evaluation programs with credit unions nationwide.

Kevin is co-author of *A Credit Union Guide to Strategic Governance*. This essential book helps governance teams become as effective as possible. He also writes the monthly TEAM Resources blog that is read by thousands nationally. The monthly blog shares guidance on board topics such as governance, strategy, and issues related to the supervisory committee.

Previously, Kevin spent 10 years at the Credit Union National Association (CUNA) in the Center for Professional Development as Director of Volunteer Education. In that role, he developed and oversaw programs for credit union executives, boards, and volunteers. This included conferences and training events, webinars, print programs, and online courses, among others. During his tenure at CUNA, Kevin created and brought several new programs to the credit union movement. One of these is the CUNA Volunteer Certification Program, an intensive, competency-based program for boards and supervisory committees, offered as a five-day onsite event or as a self-study program, both involving rigorous testing for completion. He also created the CUNA Training On Demand series of downloadable training courses and the CUNA Pressing Economic Issues series featuring CUNA economists. Behind the scenes, Kevin was involved with a team of CUNA leaders focused on creating a culture of innovation within the trade association and working toward keeping the organization forward-thinking to create new and better programs for its membership. This included participation in an IDEO design program.

Before joining CUNA, Kevin spent several years teaching at the University of Wisconsin-Whitewater. He holds a Master's degree from DePaul University, Chicago and a Bachelor's degree from Miami University, Oxford, Ohio.

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About Linda Keith

Linda Keith, CPA, draws on her 30-plus years of experience consulting with and training lending institutions; background in public accounting; 15-plus years as CFO of the family residential construction company; and experience as an Examiner with the Washington State Auditor's Office and as adjunct faculty in Accounting Principles and Managerial Accounting to help lending and credit professionals say "yes" to good loans.

Of course, you know those are not consecutive years or she'd be over 100 by now!

Linda is known by her clients to be both practical and funny. In fact, there is a movement afoot to change the 'P' in CPA to stand for 'Playful'. The fact is, people absorb ideas and learn better when they are having a little bit of fun. So, Linda brings the fun along with her practical knowledge and depth of understanding to provide credit analysis training and presentations that make a difference.

She is the founder of Lenders Online Training, a virtual classroom approach to improving tax return and financial statement analysis capabilities; the host of the Credit Risk Ready Podcast; and a consultant/trainer on credit risk to banks and credit unions across the country.

www.LendersOnlineTraining.com	Online training on credit analysis
www.LindaKeithCPA.com	Resources for banking, *Ask Linda* blog
www.CreditRiskReady.com	Podcast: Assessing, Managing and Mitigating Credit Risk and download of the *Credit Risk Readiness 2018 Study*