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# Did Bank Directors Bolt as Going Got Tough? A look at director turnover

By Katie Wagner

Director departures at publicly tradebanks and investment banks rose during the years and months preceding the financial crises, peaking in 2008. This raises questions over the reasons why these directors left just before or during tumultuous times for their companies.

In 2005 and 2006, 32.7% of these financial sector companies experienced departures. That rose significantly to 37.3% in 2007 and peaked at 40.6% in 2008 while dropping only slightly in 2009 to 38.3%. That contrasts sharply with director turnover at all accelerated filers, where departures peaked in 2007 (37.3%) and then tapered off significantly in 2008 (35.7%) and even more so in 2009 (32.5%).

The data is based on Audit Analytics' analysis of all disclosed director departures from accelerated filers between 2005 and 2009. Accelerated filers are companies with a public equity float of $75 million or more as of the last business day of the most recently completed second fiscal quarter.

It's important to note that government involvement in financial firms, which reportedly led to director departures, and bank failures don't necessarily explain why departures peaked in 2008. These events were more prevalent in 2009.

So, what does the turnover say about director retention in sectors facing crises? Experts are divided.

### The Financial Crisis

Several board recruiters see the financial crisis that erupted full scale in late 2008 as the primary explanation for the rise in directors' departing from bank and investment bank boards in 2008 and the contrast between the financial sector and corporate America in general.

"The financial crisis and the recession were really finance-driven," says Steven Kaplan, a professor at the University of Chicago's School of Business, who also serves as a director on two boards. "Since the companies that messed up or didn't perform were the financial companies, you'd expect the directors of these companies would pay the price for that."

During September of that year, Merrill Lynch agreed to sell itself to Bank of America, Lehman Brothers filed for Chapter 11 bankruptcy, the Federal Housing Finance Agency announced that Fannie Mae and Freddie Mac were being placed into federal conservatorship, and the United States Office of Thrift Supervision seized Washington Mutual Bank from Washington Mutual and placed it into the receivership of the Federal Deposit Insurance Corporation. During October, November and December of 2008 and into 2009, the federal government invested billions of dollars in hundreds of financial institutions through the TARP capital purchase program.

In general, "it has become more difficult to get people to agree to serve on boards since Sarbanes-Oxley was adopted," says Betsy Bruening, a board recruiter with the Prout Group. "One of the reasons is because board service has become a lot more cumbersome, so companies are limiting the number of boards they'll allow their directors to serve on."

"I think in the financial services sector, because of what they went through late in 2008 and throughout 2009, that those directorships have become even more cumbersome," she adds.

But those eventful last four months of the year accounted for only 38% of 2008 bank and investment bank director departures. What explains the departures for the rest of 2008 and for 2007 as well?

### Market Downturn

One theory is that when there's a market downturn, board members rethink their directorships. After peaking in October of 2007, the Dow Jones Industrial Average began a steady decline in 2008 that became a plunge in September of that year. "When you have a downturn, CEOs get fired. That was probably particularly true in the financial sector given the financial nature of this downturn; says Kaplan. "In a downturn, you might also see directors who are CEOs of other companies leave boards to focus on their own companies."

"Probably the directors who haven't been so active or who don't have a stomach for restructuring may leave a board or be forced off a board when their companies are not performing well," he adds. Several directors departed from the boards of companies months before they filed for bankruptcy or were rescued by the government or some other entity. These departures raise the question of whether these directors saw trouble on the horizon for their companies and decided for whatever reason that it was better for them or their companies that they resign.

Wachovia lost one director in 2006, and two more in 2007. The last of these departures came shortly before the company's first quarterly loss since 2001. Following that, the company's CEO Ken Thompson was stripped of his chairman tide. Then, on June 1, 2008, he was forced to leave the company entirely. All of these events preceded the sale of Wachovia to Wells Fargo on Oct. 3, 2008.

Fannie Mae also experienced several director resignations prior to the height of its financial trouble. During the second and third quarters of 2006, three of the company's directors resigned. Then, in the first quarter of 2007, another departed and late in 2007, a director declined reelection. All of these departures preceded a more than 90% drop in the company's stock price in 2008. Prior to these departures, the government also took steps to assist the company, including granting it access to Federal Reserve low- interest loans. The second and third departures in 2006 also closely preceded the company's restatement of its earnings from 2001 and 2004 and the Office of Federal Housing Enterprise Oversight's filing civil charges against three of the company's executives who had been asked to retire or had resigned in late 2004.

"I expect that directors must have been feeling the heat before the market crashed" says Don Whalen, Audit Analytics' director of research. "Let's face it, they're going to have inside information"

Dora Vell, CEO of Vell Executive Search, adds that perhaps directors decided to quit and cash out on their equity because they thought the economy was about to go under.

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A recent report by the European Corporate Governance Institute entitled "The Dark Side of Outside Directors: Do They Quit When They Are Most Needed?" seems to provide similar explanations for why directors left boards during a period beginning in 1984 and ending in 2004. (The reports findings can't be compared directly to Audit Analytics data for the years 2005 through 2009. That's because, as the report mentions, "[p]rior to 2004, departures of directors were only disclosed" in 8Ks if they were due to disagreement and the departing director explicitly requested that the nature of the disagreement be publicly disclosed. )

The report attempts to show that after companies experience a "surprise" outside director departure, those companies "have significantly worse stock prices and accounting performance, are significantly more likely to suffer from an extreme negative return event, are more likely to restate earnings and have a significantly higher likelihood of being involved in a class action suit." The report defines surprise departures as those by an outside director who is below the age of 70 — which is just below the average mandatory retirement age for directors — or satisfies some other criteria that the researchers believe make directors less likely to leave a board.

> At least some directors who left their hoards before the crisis hit may have done so in protest. "Director departures in early 2008 could be caused by either early warnings or by arrogance of the management or by [directors'] disagreeing with levels of risk or strategic direction," says Vell. "Perhaps directors left because they felt that management was concealing information from them." In cases where audit committee members left, their departures could have been due to their having felt the numbers were too aggressive, Vell says.

Of course, even in the financial services sector plenty of directors remained on their boards to help their companies through the downturn. Stanley Westreich, a long-time Capital One Financial director, is a case in point.

According to an SEC filing, Westreich remained on the board of Capital One, a recipient of assistance from the Troubled Asset Relief Program, even though he had reached the board's age limit.

In 2009, the board waived its retirement age "to enable Mr. Westreich to continue to serve as a director in light of the economic circumstances facing the financial services industry as a whole and the company's recent acquisition of Chevy Chase Bank, F.S.B., and in recognition of Mr. Westreich's continuing value to the company." On April 27 of this year, Weistrich submitted his resignation to the board, because, he stated at the time, he "believes that he has fulfilled the boards expectations and now wishes to pursue other interests."

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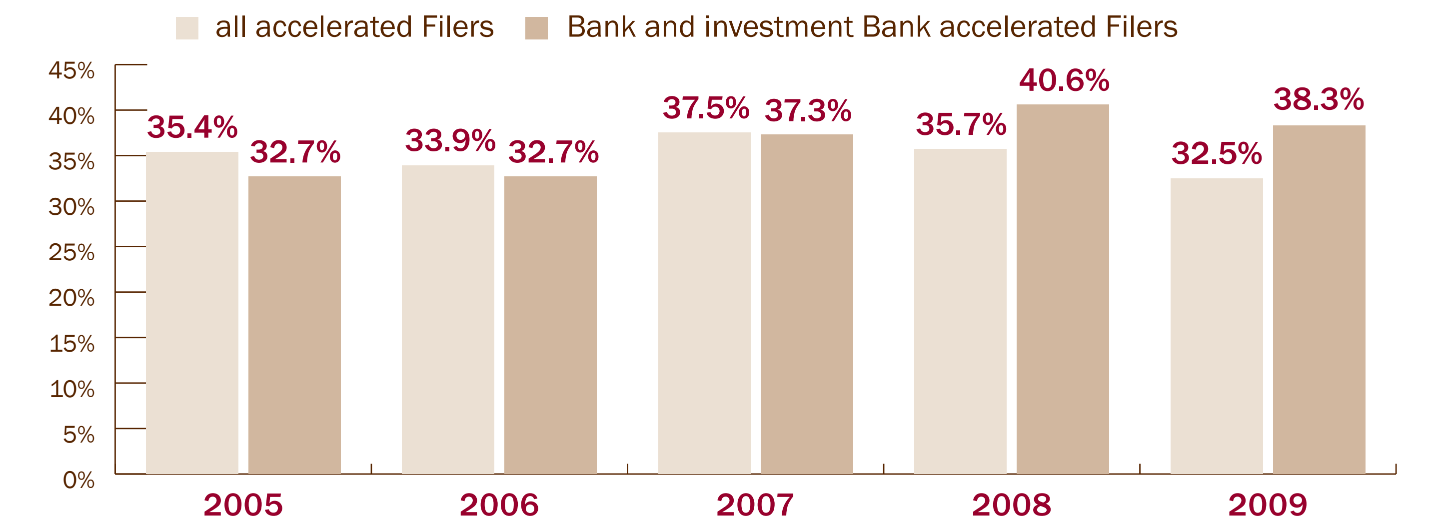
## Director Resignation Rates: Financial Sector's Acceleration

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