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# THE VIRGINIA STATE BANKER

Regulatory News for Virginia State-chartered Banks

## State Corporation Commission - Bureau of Financial Institutions

E.J. Face, Jr., Commissioner

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New State Bank

The Virginia State Banker is published quarterly by the Virginia Bureau of Financial Institutions to provide useful information to the banks and savings institutions that it regulates, and any of their related interests. Reader comments and suggestions are welcome and should be addressed to:

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## COMMISSIONER FACE TESTIFIES ON BILL THAT WOULD BAN BANKS FROM REAL ESTATE BROKERAGE

Virginia Commissioner of Financial Institutions E. Joseph Face, Jr. told a Congressional subcommittee July 24 that legislation to prevent banks from entering into real estate activities might be well-intentioned, but could actually limit consumer choice. Face testified on behalf of the Conference of State Bank Supervisors (CSBS). CSBS is the professional association of the state officials responsible for chartering, supervising, and regulating the nation's 6,000-plus state-chartered commercial and savings banks, and more than 400 state-licensed foreign banking offices nationwide.

"Like banking, real estate is a service business. And as in banking, local providers often know their customers' needs best. If this is truly the case, government intervention to protect local service providers should not be necessary," Face told the House of Representatives' Financial Services Subcommittee on Financial Institutions and Consumer Credit. "We are convinced that increased competition in real estate will benefit consumers and their communities, as well as the service providers that are eager to earn their business," he said.

Face was one of ten persons to present testimony on H.R. 3424, "The Community Choice in Real Estate Act," a measure largely supported by the National Association of Realtors and other real estate broker organizations. The American Bankers Association (ABA) and the Real Estate Service Providers Council (RESPRO) joined CSBS in opposing the proposed bill. The legislation, introduced by California Congressman Ken Calvert, addresses a proposal that is currently in the rule-making process required under the Gramm-Leach-Bliley Act of 1999. The Federal Reserve Board and Treasury Department had issued a joint proposal to allow financial holding companies to engage in real estate brokerage activities in January 2001. However, the two agencies have not issued a final rule.

Face pointed out that 29 states and the District of Columbia allow their state-chartered banks to offer real estate brokerage services. He noted, however, that currently only a small number of state-chartered banks are actively engaged in real estate, but that state bank supervisors have not encountered any significant safety and soundness or consumer protection concerns related to these real estate activities.

*See Bill, page 4*

## WHEN A DIRECTOR HAS TO GO

Many banks struggle with the issue of asking a director to step down. The reasons vary, but the task is seldom easy. The following is an article reprinted by permission from *Bank Director* magazine, Vol. 12, No. 2. We hope you find it informative and, perhaps, helpful.

**Scenario** It is not a good day for Edna Summers. As the outside chairman of the \$900 million County Savings Bank, she knows a difficult task lies ahead. Several months ago, a longtime board member who owns a real estate development company that had fallen on hard times announced that his business had filed for Chapter 11 status and he himself had declared personal bankruptcy. Because County Savings Bank is the largest and only locally owned bank in this bedroom community, other board members have been very concerned about how these negative events reflect on the bank's image. Chairman Summers and the bank CEO have been dropping hints that it might be a good idea for this director to resign from the board to separate this unfortunate situation from the bank. So far these hints have fallen on deaf ears and the rest of the board want a more definitive action. Chairman Summers is convinced that this director will not want to give up his seat. She and the CEO have decided to solicit some advice prior to determining their plan of action.

Bank Director posed the previous scenario to two corporate governance experts, George Freibert, chairman of Professional Bank Systems, Louisville, Kentucky, and TK Kerstetter, president of Bank Director. Here are their views on how the Chairman Summers ought to respond to the situation.

**BD: Is it the outside CEO's or the chairman's responsibility for solving this problem?**

**Freibert:** It's the board's responsibility. The CEO is going to have input, but it's the board's job. What they need to do is call a couple of board members that are particularly close to this bankrupt director and talk to him. They need to try to

convince him that he should resign on his own. This should be done with the understanding that if he doesn't resign on his own, the board will have no choice but to call a special shareholders meeting in order to force him off the board. Most of the time, when it is put to them in this manner, the director usually chooses the sensible path and decides to resign because of "personal reasons."

**Kerstetter:** I agree, this is clearly the board's responsibility, with outside director Ms. Summers as chairman of the board taking the lead. This is really no different than if a director was missing too many meetings or leaking information from the boardroom, it would be the chairman's responsibility, with the support of the board, to seek corrective action. That being said, if the chairman is also CEO, I would enlist some outside board members to help communicate the message that the director in question needs to hear.

**BD: Is there any rule or bank regulatory guideline about a director having to resign if he or she declares personal bankruptcy?**

**Kerstetter:** I'm not aware of any regulations on a director declaring personal bankruptcy. However, banks can and should have corporate governance guidelines that can deal with events that would harm the bank's public image.

**Freibert:** Regulatory guidance doesn't require this, but frankly, the examiners would be aghast to find a bank that didn't make a bankrupt director resign.

Another bank I worked with had a director who they told me was "on temporary leave." When I probed further about where, exactly, he was, they admitted he was in prison! Only on weekends, they explained. When I asked why they didn't oust him from the board, they said he "wanted to stay on," so they let him. At the next shareholder meeting they intended to take him off, but for his sake, they didn't want to have a special shareholders meeting which would bring more negative publicity.

**BD: How do you go about getting a director off a board?**

**Freibert:** It's very useful to have the bylaws of the institution state that a director can be removed by a majority vote of the board without calling a special shareholders meeting. I would recommend bank boards examine their bylaws and include this language if it doesn't already exist.

This type of change or amendment should be ratified by the shareholders, and it should be examined by bank counsel to ensure the language is legal in whichever state the bank is domiciled in, although I know of no state where it wouldn't be.

The bottom line is a bank is a different animal from other types of businesses. It's a repository of public money and people expect bank directors to be a cut above.

**Kerstetter:** Getting a director off the board is not as easy as it should be. Obviously if a director has committed a fraudulent act or hurt the institution by some clear action, the regulators can remove a director, or a board for that matter, by a single mandate. Outside of that power, the process a bank has to take can get more involved. Sometimes the situation will call for a special board meeting, and other times a board can wait and just not let that director in question stand for re-election.

As you can imagine, this process can get ugly if the board is divided, or the director in question is a substantial shareholder. In most cases, the meeting with the chairman, CEO, or some respected board members does the trick.

**BD: What can a bank board do to make this process less painful in the future?**

**Freibert:** This situation also makes apparent the need for a comprehensive corporate governance policy.

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*Continued on page 3*

## WHEN A DIRECTOR HAS TO GO

Continued from page 2

I consistently encourage banks to consider this type of policy, which embodies an ethics policy and a code of conduct for the board. It also covers a myriad of topics that define why a director might be asked to resign from the board, such as bankruptcy, classified loans, Reg O violations, indictment, or if the conduct of the board member is simply not consistent with the role of a bank director.

For example, years ago, a bank we worked with had a director who ran a very successful liquor business. That was fine until one day he opened up a "gentlemen's club." The board explained to him that this type of business wasn't consistent with being a director of a bank. In this case, he went peacefully.

**Kerstetter:** I have been accused of being obsessive on the need for boards to adopt governance guidelines, and this scenario is just another example of what a valuable tool the guidelines can be.

If this bank board had corporate governance guidelines (see sidebar), there would be little question what action said director should take when he filed for bankruptcy.

These guidelines should be signed by directors annually so there is no mistaking what the board best practices are. You eliminate any misunderstanding, split boards, or shareholder questions about a director's removal from the board selection slate if you create and approve guidelines.

It is a great tool for chairmen of boards, particularly when a CEO is also chairman. It is beyond me why only a low percentage of boards have actually taken the step to create guidelines.

### **BD: What advice would you give Chairman Summers in this scenario?**

**Kerstetter:** First of all, I would tell Chairman Summers and the CEO to stop hinting around and confront the director on the board's feelings

and potential damage to the bank. If they balk at resigning, it sounds like the board has a consensus that said director shouldn't stand for re-election.

This case is interesting and very lifelike when you consider that many real estate developers' companies go bankrupt at one time or another. When I was president of a bank, I started to think it was a "rite of passage" for a developer to go bankrupt at least once.

I do know one bank that handled this situation with a real estate developer director that had fallen on "temporary" hard times in a creative way. Because this director was a very valuable contributor to the board, they asked him to take a leave of absence until his company problems were corrected and they reinstated him several months later. I thought in this bank's case that it was a good plan due to the small size of the bank and this person's major contribution to board business.

## THE BOARD OF DIRECTORS CORPORATE GOVERNANCE GUIDELINES

The following is a sample of corporate governance guidelines for a bank board. Banks should modify the guidelines to fit their specific bank and board. It is important to have the board update the guidelines annually to reflect changes in the bank and board. Directors should also sign the guidelines annually to ensure that their board responsibilities are reaffirmed regularly. When incorporated properly these guidelines are a valuable tool to the bank, board, chairman, and chief executive officer.

- ◆ Every director owes a duty of loyalty to the bank and is expected to act in the best interest of the shareholders as a whole.
- ◆ The board will always have an independent outside director to serve as the lead director if the CEO holds the title of Chairman. The lead director presides at executive sessions and at meetings to evaluate the performance of the CEO.
- ◆ The Audit, Compensation, and Nominating committees will consist entirely of outside directors.
- ◆ Directors are required to own at least \_\_\_\_\_ shares of bank stock within one year of their election.
- ◆ Directors must retire or be elevated to non-voting director emeritus status by age\_\_\_\_\_.

- ◆ Attendance at board meetings and appropriate board committee meetings is mandatory. Directors missing more than 25% of scheduled board meetings during a year will submit a personal plan to the chairman or lead director to resolve the situation and eliminate the proxy statement disclosure.
- ◆ Directors should direct and managers should manage! The board should not attempt to micro-manage issues or problems that are the responsibility of management.
- ◆ Directors should be prepared for meetings and management will be as prudent as possible on delivering materials in advance of meetings, particularly for items that need to be acted upon.
- ◆ Directors are expected to assist the bank in developing new business, but must be careful not to create undue pressure on bank officers to accommodate any individual or business.
- ◆ Directors must keep boardroom information about customers and the bank confidential at all times. Individuals consciously violating this standard will be asked to resign from the board.

- ◆ Directors should avoid conflicts of interest at all costs. When a director finds themselves in a potential conflict of interest, their responsibility is (1) formally inform the board of the conflict, (2) disqualify themselves from discussing or voting on that item.
- ◆ If a director is involved in situations that are detrimental to the bank's reputation, they should voluntarily resign from the board. These situations include personal bankruptcy, public indictments, or unethical practices.
- ◆ Directors will conduct a self assessment evaluation of their performance as a board member on an annual basis.

*These corporate governance guidelines have been approved by the Board of Directors.*

*I have read and understand the code of conduct that is set forth in these corporate governance guidelines. I also understand that I will be asked to read, review, and sign the corporate governance guidelines on an annual basis.*

**BILL**

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“We believe that the states’ experience supports the Federal Reserve’s and Treasury’s interpretation of real estate brokerage as an appropriate activity for bank holding companies,” he told the subcommittee.

“The states have always been permitted to authorize powers for the institutions they charter. The importance of this authority to our nation’s economic development and to the banking system cannot be underestimated,” Face said.

In Virginia, the State Corporation Commission issued for comment on July 12, 2002 proposed Regulation in case BFI-2002-00014 (<<http://www.state.va.us/scc/caseinfo/banking/b020014.htm>>) which would allow bank acquisitions of real estate brokerage subsidiaries under certain conditions. Subdivision B 3 of § 6.1-58.1 of the Virginia Banking Act, § 6.1-3 et seq. of the Code of Virginia, authorizes the Commission to allow a controlled subsidiary corporation of a state-chartered bank to engage in any business that is authorized by statute, regulation, or official interpretation for a subsidiary of (I) a national bank or (ii) an out-of-state bank. The Bureau of Financial Institutions has proposed a regulation that will authorize, subject to application and approval, state-chartered banks to acquire controlled subsidiary corporations engaging in real estate brokerage activities. The comment period for this proposed regulation ends at the close of business September 9, 2002.

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**HOW TO FILE A COMPLAINT**

**N**ew information concerning how to file a complaint is now available on our Web site. The information includes what to do if you have a complaint and who to contact regarding your complaint; and for those entities over whom the Bureau has authority, a form is provided. This information can be found at <http://www.state.va.us/scc/division/banking/complaint.htm>.



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**VIRGINIA BANK DIRECTORS’ COLLEGE**

**T**he fall session of the 2002 Virginia Bank Directors’ College will be held at The Boar’s Head Inn, Charlottesville, Virginia, October 30 and 31. The Bureau, the Federal Reserve Bank of Richmond, and the Federal Deposit Insurance Corporation will host the program. The Virginia Association of Community Banks (VACB) will handle administrative aspects of the College, including registration and meeting activities. Membership in VACB is not required to attend the College. For more information contact the VACB at (804) 217-8250 or Mrs. Betty Hicks at the Bureau at (804) 371-9704.



# COMPANIES FINED FOR VIOLATING TRADE SANCTIONS

*This item appeared in the latest edition of the American Council of State Savings Supervisors newsletter. It is an indication of how serious the government is about companies dealing with terrorists. Please be sure you have safeguards in place to keep your institution from violating these rules.*

In the first disclosure of its kind on the extent of enforcement actions brought by the Office of Foreign Asset Control (OFAC), it was revealed that the Treasury Department has fined over 100 companies during the last four years for violations of Federal prohibitions on cash dealings with countries deemed enemies of the state. The covered countries include North Korea, Libya, Iraq and Iran.

The information, released in response to a Freedom of Information Act Request, also noted that OFAC intends to release information on approximately 180 additional cases later this year. Financial institutions, including Merrill Lynch, First Union, HSBC and Citigroup, dominated the list of major companies which have run afoul of the strict prohibitions on the transfer of any funds to or from these countries without an OFAC-granted license. Even the Los Angeles Dodgers were fined for paying two individuals in connection with a baseball tryout held in Cuba.

Stepped-up enforcement by this heretofore little noticed office is expected to continue as part of the nation's War on Terrorism.



## ASSESSMENT FEES REDUCED

The State Corporation Commission adopted the Bureau's recommendation to reduce the bank assessment fee by 10% for Fiscal 2003 (July 1, 2002 - June 30, 2003). The reduction leaves nearly \$685,000 with Virginia-chartered banks that would have been paid to the Bureau to defray the cost of examination, supervision, and regulation. This is the fourth reduction since Fiscal 1993, and the third in just the past seven years. In aggregate the four reduced fees by \$3.7 million for Virginia-chartered banks.

The Bureau thoroughly reassessed its internal operations in response to the loss of Crestar Bank in 2000. Internal processes were re-engineered, procedures streamlined, and critical investments made in new technologies. Employment shrank by nearly 20% through attrition. These measures are responsible for the Bureau's strong financial position less than three years after losing its largest bank.

The rapid consolidation in the financial services sector affects not only banks, but the bank regulatory community as well. Some states have lost all of their large state-chartered banks. With consolidation expected to continue, the Bureau seeks to remain in a financial position to adapt rapidly to sudden changes in its revenue stream. However, when operating efficiencies permit, the Bureau will defer the collection of fees beyond the level needed to provide a sound, comprehensive regulatory program.

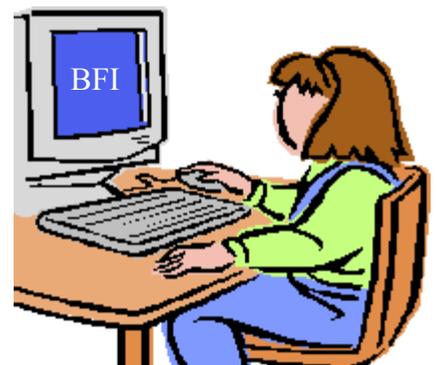


## NEW STATE BANK

The State Corporation Commission approved the application of Highlands Community Bank to begin business at 307 Thacker Avenue, City of Covington, Virginia, on July 26, 2002. The Chief Executive Officer will be H.C. Rhodes, Jr. The bank will become a member of the Federal Reserve Bank and is expected to open for business in September 2002 with minimum capital of \$7.2 million.

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