Directors&Boards

Lessons From Wells Fargo's Governance Fail

Director's job calls for more communication, less isolation

By Doug Chia and Gary Larkin

If one were to have read the press release announcing Wells Fargo's recent shakeup of its board and corporate governance changes, one would have thought the financial services company was a leader in the area of board refreshment. And why not?

For instance, the bank addressed all the right areas: it named a new independent board chair with industry expertise to replace a long-time independent director who filled in after the bank separated the chair and CEO roles; announced the retirement of two other long-term directors who had been on the board for nearly 20 years each; shuffled committee member and chair assignments; amended committee charters to stress more director independence and oversight of sales practice risk; and created a stakeholder advisory council to provide the board with insight on current and emerging risks.

Much of this was the result of a formal board evaluation facilitated by the former Chair of the SEC.

What's not to like?

The only problem is that the August 15 announcement came nearly a year after regulators discovered the bank had opened more than 2 million fake deposit and credit card accounts without permission from 2009-2016. The bank was fined nearly $200 million and agreed to pay $110 million to customers of the fake accounts. The self-inflicted damage to the company's customer, government, and public relations is immeasurable.

One would think that board members at Wells Fargo and other companies that have faced similar crises would rather have been proactive than reactive. They could have benefited from a little introspection of their jobs and their mission.

We were fortunate enough to hear from a handful of renowned directors earlier this year, who gave us their perspective on the job of a corporate board member. They articulated the difficulties of refreshing a board, the challenges of communication with management and other stakeholders, and the issues they face with activist shareholders.

Consider some of the viewpoints and conclusions of those directors:

- **Directors need to communicate regularly with each other and management about complex issues to be effective.** They also need the skills necessary to compromise and gain consensus on important issues like executive compensation, capital allocation, and shareholder engagement.

- **CEO succession planning is one of the corporate board's most important jobs.** Essentially, our director panelists agreed that there must be a regular process the board and management stick to over several years and that it needs to go beyond just the CEO.

- **While disclosure of shareholder engagement plans is not a regular practice, directors understand the importance of having such a plan.** One director panelist offered three things a board can do before engaging a shareholder: determine how much company stock the shareholder owns, communicate with the company's investor relations department, and understand if the shareholder has an issue with a particular governance area.

- **There should be a balance of generalist and specialist directors.** While there wasn't a consensus on whether boards need any specialist directors versus hiring outside consultants, almost all the directors we spoke to believe all directors should have basic knowledge about certain areas: the company's business, its industry, its competition, and how to run a business.

- **Boards can stand to develop a gap analysis of what skills directors have and what skills they need.** One director explained the reason for a third-party evaluation: "The skills of board members from 15 years ago may not be what the board needs now."

- **Board diversity should not be considered a separate goal, but rather it should be part of the regular talent search.** At least two directors we spoke to agreed that the best way to address the issue of having a low number of women and minorities on a board is to consider a larger talent pool of director nominees that doesn't have to always include CEOs.

· **While new activist directors may tend to have their own constituency, incumbent directors should proactively open lines of communication.** One director panelist opted to take such an activist director out to lunch to acclimate herself and found that person had some valuable insight into the company.

· **It is difficult for boards to remove a fellow director because of the collegiality and respect they have for each other.** Directors are conflicted about this. On one hand, they say it's awkward to initiate a discussion to remove someone from the board who is not working out, but on the other, they acknowledge the problem with leaving someone on a board who is no longer contributing.

All in all, more public corporate boards realize their job continues to evolve as stakeholders demand more of a say in how public companies operate. Whether it's a company failure, a shareholder proposal, or a social media campaign, stakeholders are concerned about board composition and structure, the knowledge base of directors, interaction with management, and shareholder engagement.

We have seen that some boards are getting this message. But the question is whether they are acting on that message in a way that will affect the makeup of the board.

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