



ENGAGED DIRECTORS. EFFECTIVE BOARDS.®

Board Leadership for the Company in Crisis

Webcast: October 30, 2008

Moderator: Michael W. Tankersley

Panelists:

From NACD

- Suzanne Hopgood
- Michael W. Tankersley

From Gibson, Dunn & Crutcher LLP

- Amy L. Goodman
- Brian J. Lane

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Panelists from NACD

Suzanne Hopgood

Served as either CEO, Chairman of the board, and/or Director on 9 boards, primarily those facing legal, financial, or regulatory issues. She co-authored *Board Leadership for the Company in Crisis* and serves as the Director, Board Advisory Services at NACD.

Michael W. Tankersley

Counseled management and boards of financial institutions and distressed companies in Texas from 1980 to 2007. In 2007 he was appointed by President George W. Bush to serve as the first Inspector General of the Export-Import Bank of the United States. He co-authored *Board Leadership for the Company in Crisis* and serves as a member of the NACD teaching faculty.

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Panelists from Gibson, Dunn & Crutcher LLP

Amy L. Goodman

Partner; Co-chair of the firm's Securities Regulation and Corporate Governance practice group. She advises clients with respect to securities disclosure, regulatory, governance, and SEC issues. She had an 11-year career with the SEC, ending as Associate Director in the Division of Corporation Finance.

Brian J. Lane

Corporate securities partner with extensive expertise in a wide range of SEC issues. He advised boards regarding governance and SEC issues. He had a 16-year career with the SEC, ending as the Director of Corporation Finance.

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Please be sure to answer the following regarding your participation in today's webcast:

Please let us know if you are:

- An outside director
- In a legal department
- With a law firm
- Other

Abbreviated Timeline of Key Events



- **March 16, 2008** – Bear Stearns collapses and is taken over by JP Morgan. The Federal Reserve finances the transaction.
- **September 7, 2008** – Fannie Mae and Freddie Mac are placed into conservatorship under authorities established by a housing bill enacted less than 45 days earlier.
- **September 16, 2008** – The Federal Reserve grants AIG an \$85 billion credit facility.
- **September 19, 2008** – The Treasury Department announces a temporary guarantee program for money market mutual funds.
- **September 19, 2008** – The Treasury Department proposes legislation to establish the Troubled Asset Relief Program, or “TARP.”
- **September 21, 2008** – The Federal Reserve approves applications by Goldman Sachs and Morgan Stanley to become bank holding companies.
- **September 25, 2008** – Washington Mutual is seized by the Federal Deposit Insurance Corporation and most of its assets are transferred to JP Morgan Chase.

Abbreviated Timeline of Key Events (cont.)



- **September 29, 2008** – The rescue bill, named the Emergency Economic Stabilization Act (“EESA”), fails in the House of Representatives by a vote of 205 to 228. The Dow suffers the largest drop in the history of the index.
- **October 1, 2008** – The United States Senate passes the EESA by a vote of 74 to 25. The bill now contains tax and energy components.
- **October 3, 2008** – The House of Representatives, on its second try, passes the EESA 263 to 171. The President signs the bill the same day.
- **October 7, 2008** – The Federal Reserve announces the Commercial Paper Funding Facility to inject liquidity into the term commercial paper market.
- **October 14, 2008** – The Treasury Department announces the Capital Purchase Program, through which it will use TARP dollars to make direct investments in banks.
- **October 14, 2008** – FDIC announces creation of the Temporary Liquidity Guarantee Program.

TARP Overview



- Creates new, up to \$700 billion program to purchase “troubled assets” from “any financial institution.”
- Creates parallel insurance program.
- Creates new Treasury “Office of Financial Stability” to be headed by a presidentially-appointed assistant secretary who will run program.
- Authorities terminate on December 31, 2009.

Key Definitions (Section 3)



Financial Institution

- “any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States . . . and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.”

Troubled Assets

- “(A) residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability; and
- (B) any other financial instrument that the Secretary . . . determines the purchase of which is necessary to promote financial market stability”

Implementation – On a Fast Track (Section 101)



Within 45 days from enactment (November 27th), the Secretary must issue guidelines on:

- Purchase mechanisms
- Pricing and valuation methods
- Asset manager selection procedures
- Criteria to identify assets for purchase

Oversight Mechanisms (Sections 104, 116, 117, 121 & 125)



Financial Stability Oversight Board

- Government heavyweights
- Mainly advisory

Comptroller General

- Audit/Oversight function
- To conduct study on margin authority

Special Inspector General

- PAS position
- Audits and Investigations

Congressional Oversight Panel

- Selected by leadership
- Reporting function
- To produce special report on regulatory reform

TARP Implementation



- **October 6, 2008** – Treasury issues four solicitations for whole loan and securities asset managers, a custodian/auction manager, and an investment management consultant. Submissions were due by October 8, 2008. Hundreds of submissions are filed.
- **October 10, 2008** – Simpson, Thatcher & Bartlett selected as legal adviser.
- **October 11, 2008** – Ennis Knupp selected as investment management consultant.
- **October 14, 2008** – Bank of New York Mellon selected as master custodian and auction manager.
- **October 21, 2008** – Treasury announces selection of PricewaterhouseCoopers and Ernst & Young to conduct accounting and internal controls services for TARP.
- Nevertheless, no troubled whole loans or mortgage-related securities have been purchased as yet.

TARP “Capital Purchase Program”



- Under TARP authority, Secretary Paulson has established the Capital Purchase Program in order to invest up to \$250 billion in financial institutions in exchange for non-voting senior preferred stock and warrants.
- Nine large financial institutions (Citigroup, JP Morgan Chase, Bank of America (including Merrill Lynch), Wells Fargo, Goldman Sachs, Morgan Stanley, Bank of New York Mellon, and State Street) agreed to receive equity investments totaling \$125 billion.
- Equity interests to constitute Tier 1 capital for participating institutions.
- Participating institutions will be subject to strengthened corporate governance and executive compensation standards, including a ban on golden parachutes and clawback provisions.
- Reaction from smaller banks has been mixed. Some see this as a fairness issue with the government bailing out larger banks that took risks while smaller banks that stuck to more traditional mortgage portfolios are comparatively disadvantaged.

FDIC Temporary Liquidity Guarantee Program



- The FDIC announced this new program to guarantee newly-issued senior unsecured debt and demand deposit accounts at certain financial institutions.
- The program applies to a narrower of entities than does TARP, and is limited to the following: (1) FDIC-insured depository institutions; (2) U.S. bank holding companies; (3) U.S. savings and loan holding companies operating in compliance with section 4(k) of the Bank Holding Company Act; and, most recently, (4) Other affiliates of insured depository institutions that the FDIC decides to bring into the program.
- The program is comprised of two parts, both of which will apply to eligible entities unless they affirmatively opt out.
 - First, a guarantee of eligible entities' unsecured debt issued on or before June 30, 2009. The amount of debt will be limited to 125 percent of debt outstanding as of September 30, 2008 and maturing before June 30, 2009. The FDIC will charge an annual fee of 75 basis points for each dollar of guaranteed debt.
 - The second component is a lifting of the Federal Deposit Insurance Act limit on the guarantee on funds in non-interest-bearing transaction deposit accounts. Eligible accounts would have no insurance limit until December 31, 2009. However, the FDIC will impose a 10 basis point surcharge on covered accounts.
 - This would mostly affect business customers, which keep high transaction account balances to meet payroll, etc.
 - We understand that the FDIC limited coverage to non-interest-bearing transaction deposit accounts at least in part so as not to upset the balance between bank deposits and money market mutual funds.

Federal Reserve Funding Facilities



There are three:

- The **Asset Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF)**, administered by the Federal Reserve Bank of Boston, offers loans to banking entities to purchase asset backed commercial paper from money market mutual funds;
- The **Commercial Paper Funding Facility (CPFF)** funds purchases of highly rated, U.S. dollar denominated, three-month, unsecured and asset-backed commercial paper issued by U.S. issuers; and
- The **Money Market Investor Funding Facility (MMIFF)** will fund purchases of dollar-denominated certificates of deposit, bank notes, and commercial paper issued by highly rated financial institutions with maturities of 90 days or less from U.S. money market mutual funds and, over time, possibly other money market investors.

The Challenge of Crisis Leadership



The primary task of a company's leaders, according to Peter Drucker, is:

“...to make sure of the institution’s capacity for survival – to make sure of its structural strength and soundness, of its capacity to survive a blow, to adapt to sudden change, and to avail itself of new opportunities.”

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Credit cards could be next potential bank headache.

As financial companies stop offering the cards to consumers with good credit, they risk heavy losses from a pullback in business that fueled big gains over the past decade. The number of defaults is also on the rise as the financial crisis worsens. "We are not going to say, 'Yahoo, this is over,' and extend credit like we did without fear. If you're not fearful, you're crazy,"

- Jamie Dimon, JPMorgan Chase's chief executive, in a recent conference call

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Business crises are typically worse, frequently much worse, than is first disclosed to the board

- Details of a problem typically has to pass through several layers of employees to reach senior management and the board
- Negative reactions, such as denial, cover-up, shooting the messenger and attempts to “solve the problem first,” slow response time
- Mistakes are more likely to be made, and opportunities missed, as management and the board take action based on incomplete information
- The accuracy and speed of information flow from the site of a problem to senior management and the board is directly related to the degree of transparency and commitment to high ethical standards in an organization

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A bias toward overreaction – over-commitment of resources, over-commitment of board attention – is much safer than “waiting to see.”

- The cost of being prepared for a crisis that does not materialize is much lower than the cost of not being prepared for one that does.
- Companies that act “too soon” get better results than those acting “too late” in selling assets, borrowing or raising equity capital, when they are in obvious distress.

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After effective crisis planning, the two prime determinants of how a company will weather a serious business crisis are:

- Board and management experience and bandwidth to handle the business and the crisis
- Adequate cash
- The board should focus constant, forward-looking attention on both issues.

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Ten elements of sound crisis response planning

1. “Best practice” corporate governance standards.
2. High ethical standards throughout the organization.
3. A well-functioning risk management program.
4. Regular efforts to identify and evaluate specific risks.
5. Well-developed crisis scenarios and responses.
6. An identified “chief risk officer” executive in charge.
7. A multidisciplinary crisis response team.
8. Regular crisis response drills.
9. Response skills training, including media relations.
10. A written company-specific crisis response plan.

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First Day Questions: The Company's Response

1. Is this crisis addressed by prior company planning?
2. Who is on the crisis response team? What additional resources may be needed?
3. Has the company's response demonstrated concern for the health and safety of individuals and support for any individual victims and their families?
4. Is the availability of any member of the company's crisis response team, especially the CEO and/or CFO, compromised by the nature of the crisis? Any suggestion of fraud or illegal actions by any company employee?

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First Day Questions: The Company's Response

5. What decisions and actions by the company in response to the crisis have been identified by management, and what is the status of each? If immediate actions are required, what are they, why are they necessary and what is proposed to be done?
6. Is the company's crisis response team getting a steady flow of reliable information as needed?
7. Has management identified future adverse consequences of the crisis and the company's response? Is it subject to getting materially worse as time goes on, and if so how? Are preemptive actions by the company possible in the near-term?
8. What is management's immediate, near- and long-term plan of action to respond to the crisis at this point?

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First Day Questions: The Company's Response

9. Does management have the necessary time and skills to run the business and manage the crisis?
10. Are the company's communications advisors engaged?
11. Is the company's ability to respond constrained? Is there adequate time, information, communications capabilities, manpower, expertise, cash, material goods, governmental action, cooperation and support by employees, vendors, customers, lenders, government agencies?

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First Day Questions: The Company's Response

12. What are the immediate and future financial demands of the crisis on the company? Is there risk of debt covenant defaults or other consequences of the crisis that could block adequate funding? If everything that could go wrong does, would the company face a threat of insolvency?
13. What are the legal issues associated with the crisis for the company, management and the board that will be relevant to the company's response? Is there any risk of personal civil or criminal liability for any of these individuals, or the company, resulting from the crisis or any of the company's responses?

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In summary, a well-thought-out crisis response plan will identify:

- Direct and indirect consequences
- The “first responders”
- Conditions and responses that might impair the long-term viability of the company.
- The key members of the crisis response team
- The preparations and resources required

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A well-thought-out crisis response plan will also:

- Address the impact of the crisis on all stakeholders
- Address demands of the response
- Break the crisis into smaller, manageable parts
- Include a timeline
 - Identify company's actions and announcements
 - Hour-by-hour for the first 24 or 48 hours

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A company faces two crises. The crisis itself, then how it handles the crisis, which may define the company's reputation for the foreseeable future. Crisis planning increases the odds the company will survive.

Compensation Committees



EESA provisions—substantive requirements concerning executive compensation

- Clawbacks
- Incentives cannot encourage unnecessary and excessive risks
- Restrictions on severance arrangements
- Limits on deductibility

Department of Treasury regulations—defer to compensation committee with respect to risk of incentives, but require certification

Compensation Committees (*cont'd*)



SEC Corp Fin Director John White speech

- Financial institutions subject to EESA—SEC review
- Other companies—suggestion that they consider the particular risks an executive is incentivized to take to meet target

Compensation Committees (*cont'd*)



What's a compensation committee to do?

- Consider EESA provisions such as clawbacks and severance arrangements
- Consider risks that are being incentivized
- Consider implications of failing to meet threshold performance targets for annual and multi-year plans
- Consider implications of lower stock prices
- Consider tax and disclosure ramifications

Nominating and Governance Committees



Is the board properly structured to address the issues it faces?

- Does it have the appropriate committee in place?
- Should it have a risk committee? Should the full board address risk issues?

Nominating and Governance (*cont'd*)



Does the board have the “right” directors to address the issues it faces?

- Conduct a skills/experience assessment
- Succession planning for the board

Senior management succession planning



Accounting challenges

- FAS 157 Fair Value Measurements
- Impairments

Keep current on literature

- Require presentations from management and outside auditor.

More pressure on accounting in a down market

Focus on MD&A disclosure

Finance Committees



- **Do you have the right advisors?**
- **Do you understand the risks?**
- **Capital markets planning.**
- **Increased chance of hostile bid.**



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Thank You

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<http://www.nacdonline.org/expressource/expressource.asp>

**To submit additional questions or comments to
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If you have any CLE questions, contact

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