

2013 HOUSE INDUSTRY, BUSINESS, AND LABOR

HB 1164

2013 HOUSE STANDING COMMITTEE MINUTES

House Industry, Business and Labor Committee

Peace Garden Room, State Capitol

HB 1164

January 21, 2013

Job 17419

Conference Committee

Kristie Hetmyer

Explanation or reason for introduction of bill/resolution:

Standard of conduct for directors of financial institutions

Minutes:

Testimony 1

Hearing opened

0:08 **Marilyn Foss**, general counsel for ND Bankers Association: Written testimony 1. Supports HB 1164. The substance of the bill is taken from Corporations Act when the Legislative Assembly has adopted comprehensive codes for example for business corporation, partnerships, LLC, ...Included in those codes are standards of conduct for Directors, Manager, and governing entity. We looked at how we might encourage that, and by including a standard of conduct might help that. Substantively, what this bill does is require a director to act reasonably, under what's call a prudent man standard, to act in good faith, to act in accordance with laws on conflict of interest. What it enables directors to do is to rely on the opinions and advise of experts. It provides that if you have specialized knowledge as a director, you have to use that specialized knowledge. If you do these things, that you act reasonably and use specialized knowledge and don't go off on a tangent one way or another says by doing so you will not be held liable essentially to a shareholders. 3:17 The banking commissioner did as me to direct whether this is consistent with the current statutes such as; removal authority in the state banking board. Those statutes do not hold a director liable, and this is all about Director liability, but also these standards are also consistent with the standards that apply in order for the State Banking Board to exercise is removal authority or its authority to impose civil monetary penalties. 3:55 This is the reasonable person standard. In order to get their proof in they have to more than unreasonableness. The Commissioner and Commissioner Assistant all agree that is consistent with the supervisory statutes.

Representative Gruchalla: 4:31 Is this common language for how other states refer to banking code?

Foss: This is a very common standard. 4:50. Typically, those are very common standards in financial institutions and across the board.

Chairman Keiser: 5:37 On page 1 subsection 3, line 22, the definition of specialized knowledge. Is hearsay considered specialized knowledge? Example?

Foss: 6:10 Tax specialist for tax issues, an Attorney for legal issues but should also include specialty to banking..

Chairman Keiser: So it is not hearsay, it can be put on the record?

Foss: I have never heard it described as something you learned on the street.

Rep Kasper: Does this bill have anything to do with Dot Frank?

Foss: It has to do with the need for financial institutions to have good Directors. That is not a specific **Dot Frank** issue. It came to my mind in the dispute between Directors of a bank that was in receivership in Georgia. One of the things this bill contains that I think will be helpful for banks is that it makes very clear that if you're at a meeting and action was taken, if you did not vote no you voted yes.

Representative Ruby: 8:30 Do these provisions need to be in statute? Couldn't they be in some by laws or rules for individual institutions to have their own guidelines as far as duties of the Director and liabilities?

Foss: 8:49 Institutions may have them in their documents and can be helpful but If you are going to be able to rely on them in dispute, they are more protective.

Representative Kreun: 9:09 Page 2, line 15, The conflict of interest adopted by the Board, so in other words the conflict of interest is not addressed as a standard of conduct?

Foss: Conflict of interest policy is encouraged for Boards. The section above it refers to the business code that is also conflict of interest. In this bill, we have the minimum conflict of interest requirements as fourth in the Corporations Act, essentially the board policy would be in addition to that.

Representative Kreun: 10:10 That's not going to be standard code, is that what you're saying?

Foss: 10:25 I would say that's correct.

Representative Kasper: 10:55 Getting back to the conflict of interest. Example from small town, Board of Directors on the bank probably knows everybody in town, is there an inherent conflict of interest simply because you know somebody in the city that is applying for the loan or that just come under the prudent man rule?

Foss: One of the reasons you want local directors is because of their knowledge in the community and involvement, so no general knowledge is not regarded as a conflict of interest. Situations where say I am a Director and I am selling property to someone, the buyer comes in and applies for a bank loan, I would say that would be a conflict of interest.

Representative Frantsvog: 12:05 If this bill passes, what would financial institutions have to do to be certain that they were in tune with terms and conditions of this law?

Foss: They'd have to be aware of it, familiarize themselves with the provisions. The provisions are not from left field. The requirement to act in good faith as a Director is already found in banking code under the provisions. The concept of being reasonable and relying on advice of directors there are for instance the OCC has a book on Directors duties, those concepts are already in place. What this does is put them in statute and makes them more protective of the Directors who followed them.

Representative Frantsvog; 13;25 Wouldn't it take a written interpretation of the law so that as a Director they would what this says?

Foss: As I said, you would need to be aware of it. For example, when there are changes in laws, we alert our members. The Dept. of Financial Institutions also informs banks when new laws apply. 14:25 At least in my view, this wording is reasonably clear. There is case law to help people interpret this. Directors need to be aware that if they did not vote no, then their vote is understood that it is yes.

Representative Kreun: 15;13 If you go through with this and directors do not follow this, what penalty?

Foss: Liable for the damage

Chairman Keiser: 15;45 If you look at the bill as proposed, we're adding the prudent person standard. What is the standard now? Are we just assuming that it goes to the corporation?

Foss: Litigation in other states over what is the standard. This bill would clarify that.

Chairman Keiser: 16:40 Page 2, lines 16-18. It's confusing to me regarding limiting liability for the director. Should we be adding "for the following" or something?

Foss: This is the language used in the other statutes, I would not have objection to that

Support:

Jim Goetz, Chairman and CEO of Security first Bank. Also part of the Legislative Committee of the Bankers Association: Support HB 1164

Opposition:

Neutral:

Hearing closed.

Representative Ruby: Motion to do pass

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Rep Beadle: Second

Chairman Keiser: 18:55 DNO insurance.

Roll call vote 15, 0

Absent 0

Date: 1-21-2013

Roll Call Vote #: 1

**2013 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1164**

House Industry, Business, and Labor Committee

Legislative Council Amendment Number _____

Action Taken: Do Pass Do Not Pass Amended Adopt Amendment

Rerefer to Appropriations Reconsider Consent Calendar

Motion Made By *Ruby* Seconded By *Beadle*

Representatives	Yes	No	Representatives	Yes	No
Chairman George Keiser	✓		Rep. Bill Amerman	✓	
Vice Chairman Gary Sukut	✓		Rep. Joshua Boschee	✓	
Rep. Thomas Beadle	✓		Rep. Edmund Gruchalla	✓	
Rep. Rick Becker	✓		Rep. Marvin Nelson	✓	
Rep. Robert Frantsvog	✓				
Rep. Nancy Johnson	✓				
Rep. Jim Kasper	✓				
Rep. Curtiss Kreun	✓				
Rep. Scott Louser	✓				
Rep. Dan Ruby	✓				
Rep. Don Vigesaa	✓				

Total Yes 15 No 0

Absent -

Floor Assignment *Amerman*

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1164: Industry, Business and Labor Committee (Rep. Keiser, Chairman)
recommends **DO PASS** (15 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING).
HB 1164 was placed on the Eleventh order on the calendar.

2013 SENATE INDUSTRY, BUSINESS, AND LABOR

HB 1164

2013 SENATE STANDING COMMITTEE MINUTES

Senate Industry, Business and Labor Committee Roosevelt Park Room, State Capitol

HB 1164
March 6, 2013
Job Number 19482

Conference Committee

Committee Clerk Signature

Eva Lubelt

Explanation or reason for introduction of bill/resolution:

Relating to a standard of conduct for directors of financial institutions

Minutes:

Testimony Attached

Chairman Klein: Opened the hearing.

Representative Nancy Johnson: Introduced the bill. It was requested to be put in by the North Dakota Bankers Association. It has to do with standard of conduct for directors of financial institutions.

Senator Campbell: Said he is a director of a financial institution and is in support of the bill. They are under a high standard of accountability currently and they want to continue that.

Marilyn Foss, General Counsel for the North Dakota Bankers Association: Written Testimony Attached (1). (2:00-8:30)

Chairman Klein: Asked if this was protection for the Directors.

Marilyn Foss: Said that is exactly right, this is intended to protect directors and put down the rules and enable banks to get better directors.

Senator Murphy: Asked if this was about setting out what behavior is acceptable and what is desired.

Marilyn Foss: Said it says that what is acceptable is that you behave reasonably.

Senator Murphy: Asked if this was model language from other states, used in other states or new here.

Marilyn Foss: Said it is model language in the sense that it comes from the model business corporation act, which has been adopted in many states if not all states. It is a similar standard that this legislation has adopted for the rules that govern, LLC, LLP partnerships.

Chairman Klein: Said we already have it on the corporate side, those other entities that you just talked about.

Marilyn Foss: Said yes we do already have it in those acts and I would note that this would not be the first time that we have used the business corporation act and provisions in that act with respect to directors to put it in the banking code several years ago when there was an issue to whether banks in North Dakota had the power to indemnify directors, we adopted a statute which said they had the same power to do that as business corporations do under the business corporation act.

Senator Andrist: Commented that by the time they figure out someone has not been judicious the money would already be lost. If a bank officer is aware that another officer has done some indiscreet things and has been silent about it but has not been complicit in any way, does he have protection for that?

Marilyn Foss: Said this bill pertains to directors, so if you're not a director it does not pertain to you at all. There are statutes that require bankers and banks to report suspicious activities. That includes misconduct without respect to a dollar amount if it involves a bank insider. That is a federal statute and part of the bank secrecy act.

Robert Entringer, Commissioner of the Department of Financial Institutions: In support of the bill.

Senator Andrist: Gave an example of an incident and asked if this bill would help with such a situation. (14:14-15:35)

Robert Entringer: Said it is generally too late and it wouldn't of helped in that situation. This bill only protects those individuals that are acting appropriately in their role as a director of a bank.

Chairman Klein: Said it was hard to prove if directors are doing anything inappropriately because they are just an outside group that meets for discussion on bank policy. Whereas it is the officers or the folks that actually get their hands on the cash that are already regulated and already have to follow federal law.

Robert Entringer: Said for an independent outside director that is correct they don't have their hands on the money, their role is to set policy and in some cases approve loans. As the bill is written they are relying on experts within the bank or outside experts that are guiding them. If they rely on that expertise they are protected. They encourage directors to vote no if they don't like the deal and to make sure their vote is recorded in the minutes, so they do protect themselves. (17:05-18:25)

Marilyn Foss: Said frequently we have directors who say they are uncomfortable with an action but didn't feel free to vote no. One of the things that this bill does is to make it very clear that you do not get to vote no in your heart. It makes it very clear that if you are present at a meeting and a vote was taken you are presumed to have voted yes unless you vote no.

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Jack McDonald, Independent Community Banks of North Dakota: In support of the bill.

Chairman Klein: Closed the hearing.

Senator Andrist: Moved a do pass.

Senator Sinner: Seconded the motion.

Roll Call Vote: Yes - 7 No - 0 Absent - 0

Floor Assignment: Senator Andrist

**2013 SENATE STANDING COMMITTEE
 ROLL CALL VOTES
 BILL/RESOLUTION NO. 1164**

Senate Industry, Business, and Labor Committee

Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: Do Pass Do Not Pass Amended Adopt Amendment
 Rerefer to Appropriations Reconsider

Motion Made By Senator Andrist Seconded By Senator Sinner

Senators	Yes	No	Senator	Yes	No
Chairman Klein	x		Senator Murphy	x	
Vice Chairman Laffen	x		Senator Sinner	x	
Senator Andrist	x				
Senator Sorvaag	x				
Senator Unruh	x				

Total (Yes) 7 No 0

Absent 0

Floor Assignment Senator Andrist

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1164: Industry, Business and Labor Committee (Sen. Klein, Chairman) recommends **DO PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). HB 1164 was placed on the Fourteenth order on the calendar.

2013 TESTIMONY

HB 1164

TESTIMONY OF MARILYN FOSS
(NORTH DAKOTA BANKERS ASSOCIATION)

①

1-21-2013

HB # 1164

HB 1164

Mr. Chairman, members of the committee, I am Marilyn Foss, general counsel for the North Dakota Bankers Association. I am here to testify in favor of HB 1164 which would add a provision of law in the banking statutes to provide an explicit standard of conduct for directors of "financial institutions", a defined term that includes banks and industrial loan companies. (However, this defined term does not include credit unions which are governed under separate laws in Title 6.)

HB 1164 is modeled on the statutory standards of conduct that the legislative assembly has adopted for business corporations (N.D.C.C. 10-19-50). The legislative assembly has also seen fit to impose specific standards of conduct to apply to the people, however designated, who are responsible for governing limited liability companies (N.D.C.C. 10-32-96), partnerships (N.D.C.C. 45-16-04) and limited partnerships (N.D.C.C. 45-10.2-44).

Although banks operate on a "corporate model", they are not chartered under the business corporations act and are not subject to an explicit statutory standard of conduct. HB 1164 is to rectify this situation by adopting for an applying to bank directors a director's standard of conduct that is substantially that which applies to business corporations and which has been taken from N.D.C.C. 10-19-50.

The standard of conduct in this bill generally provides that a director is not liable for actions that are those of a prudent person and not tainted by impermissible conflicts of interest. The bill recognizes that a prudent director may rely on information and advice of business professionals and provides that a director that has specialized knowledge may, in a particular situation, be held to a higher standard than

applies to a director who does not have that same, specialized knowledge. This applies in practice to require a director who is a tax expert, for example, to act as a reasonable tax expert would act based upon the knowledge and expertise that a tax expert would have. Similarly, a business attorney-director is held to act as a reasonable business attorney would act, and not be able to rely on the advice of a general practice attorney, rather than on his or her own specialized knowledge. Guidance as to conflicts of interest is given by reference to the conflicts of interest section of the business corporations act. If a question arises, the board and its legal counsel may refer to that act for the specifics about conflicts that may be "waivable" and those that are impermissible under all circumstances and effectively constitute breaches of fiduciary duties.

I would note that gaps in the banking law as it relates to governance of banks have previously been addressed by looking to the business corporations act and by applying that law to banks. The example which comes to my mind relates to a bank's power to indemnify employees and directors which gives banks the same power to indemnify as business corporations have under N.D.C.C. 10-19.1-91.

Commissioner Entringer has asked me to address this bill within the context of existing statutes that provide for removals of bank directors. He would like the legislative history to be clear that this bill does not interfere with the oversight and regulatory authority of state bank supervisory officials. Certainly it is not intended to do that. N.D.C.C. 6-01-04.1 allows the removal of a director (or other bank employee) for violations of laws, orders, or written agreements, for taking actions that are unsafe and unsound, or for committing breaches of trust or breaches of fiduciary duty. I do not see this bill as being in any way inconsistent or contrary to N.D.C.C. 6-01-04.1 simply because it is not prudent or reasonable for a bank director to violate laws, authorize actions that are unsafe and unsound, or breaches of trust

or fiduciary duty. I do not see any court as interpreting HB 1164 to authorize conduct that would subject a director to removal under section 6-01-04.1.

We believe the adoption of the standard of conduct that is set forth in HB 1164 will give existing and future bank directors statutory guidance when they have questions about what standards apply and will help our banks recruit and retain qualified directors. For these reasons, I urge you to give a Do Pass to the bill.

TESTIMONY OF MARILYN FOSS

(NORTH DAKOTA BANKERS ASSOCIATION)

HB 1164

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Although banks operate on a "corporate model", they are not chartered under the business corporation act and are not subject to an explicit statutory standard of conduct. HB 1164 is to rectify this situation by adopting for bank directors a director's standard of conduct that is substantially the same as that which now applies to business corporations under N.D.C.C. 10-19-50.

The standard of conduct in this bill generally provides that a director is not liable for actions that are those of a prudent person and not tainted by impermissible conflicts of interest. The bill recognizes that a prudent director may rely on information and advice of business professionals and provides that a director that has specialized knowledge may, in a particular situation, be held to a higher standard than applies to a director who does not have that same, specialized knowledge. This applies in practice to

require a director who is a tax expert, for example, to act as a reasonable tax expert would act based upon the knowledge and expertise that a tax expert would have. Similarly, a business attorney-director is held to act as a reasonable business attorney would act, and not be able to rely on the advice of a general practice attorney, rather than on his or her own specialized knowledge. Guidance as to conflicts of interest is given by reference to the conflicts of interest section of the business corporation act. If a question arises, the board and its legal counsel may refer to that act for the specifics about conflicts that may be waived and those that are impermissible under all circumstances and effectively constitute breaches of fiduciary duties.

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We believe the adoption of the standard of conduct that is set forth in HB 1164 will give existing and future bank directors statutory guidance when they have questions about what standards apply and will help our banks recruit and retain qualified directors. For these reasons, I urge you to give a Do Pass to the bill.