GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Wisconsin, Louisiana, and Illinois!

CIVIL MONEY PENALTIES

As many of you know, I served on the board of a community bank for a number of years. Clients and friends always wondered why I would do that when I had spent the early part of my career suing bank directors and officers when their banks failed. My response was always that the risk was manageable. What is the risk of serving as a community bank director? I basically view it as three risks: (1) your bank could fail (not likely); (2) you could get sued by shareholders (covered by D&O insurance); or (3) you could be assessed a civil money penalty by the regulators. I always viewed the assessment of a civil money penalty against an individual director as an institution-affiliated party as really the biggest risk.

The OCC has recently put out its new guidance on civil money penalties, including the civil money penalty matrix for both financial institutions and individuals. For financial institutions, the penalties can be significant – up to 1% of total assets. For individuals, don't worry, because the penalties generally top out somewhere north of $175,000. Actually, the law provides that you can be penalized $2,000,000 per day per violation. Most of us could not stand much of that.

In any event, keep an eye on the penalty issue. Penalties can be assessed for any violation of law, rule, or regulation, which is about broad as it is long. Keep in mind also that if your bank is involved in a penalty assessment, it begins with a "15-day" letter from whoever your primary federal regulator is. That gives you 15 days (or longer if we ask for additional time) to respond and convince them that no penalty is appropriate.

If anyone has not seen this particular OCC Supervisory Bulletin with respect to the OCC's Policies and Procedures Manual (PPM 5000-7), let me know and we will email it to you.

Keep in mind that all of the federal regulators basically follow the same guidance.

FEDERAL HIGHWAY BILL

I had a conversation with a client the other day that involved an extremely odd situation. As most of you are aware, the Federal Highway Bill was an end-run by Congress to pay for the highways by ripping off money that had been going to the banks through dividends on their Federal Reserve Bank stock. Fortunately, through the national trade association efforts, although the concept did not get killed, it got killed for banks under $10 billion.

This particular client is well under $1 billion. They indicated they converted from a fed member bank to a non-member bank a number of years ago. For some reason, apparently triggered by the Highway Bill and the look at dividends, the Federal Reserve did an audit and went back and found that they had paid too much in dividends to this particular bank. They are now demanding their money back, basically immediately. This particular client is firmly convinced that the Federal Reserve never would have discovered their own error but for the fact they had to go back and look at dividends being paid under the Highway Bill and discovered this discrepancy, which is almost eight years old. Although the amounts in the bigger scheme of things are not large, they are large for this particular community bank. The Federal Reserve, however, as a practical matter, is simply going to debit their account. Interesting situation.

THE FAMILY-OWNED BANK

Out of the 6,000 or so community banks remaining in the country, there are still a lot that are family-owned or family-controlled. I was recently with one such bank. The key in this family-owned bank is that the patriarch, who is contemplating retirement (not real soon), introduced me to both his son in his late twenties, and his daughter in her mid-twenties, who have now gone on the board of directors of this particular community bank. The son has also come back home to work in the bank. It is pretty apparent that management succession is in place, although not in the near term.

Family-owned community banks will be around for a long, long time, provided there is management succession and ownership transition from one generation to the next. This particular bank, in the $100 million to $200 million category, is well on its way toward succeeding in both respects.

THE ICBA CONVENTION

Four members of our firm, Jeff Gerrish, Philip Smith, Doc Bodine, and Greyson Tuck, are just back from the ICBA Convention in New Orleans, the largest gathering of community banks in the country. Our firm is fortunate in that we had the opportunity to present four workshops. The handout material and the PowerPoints from those workshops can be obtained off our website at www.gerrish.com. You may be particularly interested in the "Ten Warnings for Community Bank Directors and Officers." This particular presentation addressed 10 major issues that every bank director and officer needs to focus on in the current environment. This is everything from if you want to keep your bank independent you need to plan for it, to don't let mandatory retirement do your dirty work for you, and everything in between.

If anyone wants a hard copy of any of this material or a separate email, please let us know and we will forward it on.

THE HARD DECISION

I was recently visiting with a client who, when I asked him how the bank was doing and how his year had gone, answered that the bank was doing fine, but his year was full of hard decisions. As I explored that with him further, he indicated that his community bank is family-owned bank and he has a couple of family members working in the bank. He is going to retire as CEO, and he had to decide is a family member going to come in as CEO or is another person in the bank going to come in as CEO. He passed over one of his own children to appoint another individual in the bank as his CEO replacement. He (understating) said that the decision did not go over real well with his spouse. He did indicate that that decision was one of the hardest decisions he had to make in his life, but he had to put the bank and all the shareholders, not just his family, first. He felt the choice he made, as difficult as it was, for management succession was clearly the right one for the bank. The moral of this story is sometimes we all have to make the tough decisions. It is more important that they be right than politically convenient. This particular CEO is still standing after making a tough decision (although I did notice his wife was not with him).

COMMUNITY BANK MERGERS & ACQUISITIONS

The last two *Musings* have both led off with "rants" about community bank independence. This past week at the ICBA National Convention, we received a number of comments regarding our stance on independence. One of the questions I received that I thought was interesting was whether our stance on independence makes us a de facto opponent of community bank mergers and acquisitions. In short, the response is no!

Our stance on community bank independence is that it is simply a strategic alternative for community banks. This stance does not mean we are opposed to community bank mergers and acquisitions. As you know, we do a number of deals each year, and all of these (we like to think) make great strategic sense for our client.

This really is not a question of having to be either a buyer or seller in today's market. It is really an issue of establishing an appropriate strategic direction. If a community bank wants to remain independent and not be a buyer or seller, we think that is a viable alternative. However, if it makes more strategic sense to be a buyer or a seller, we are completely on board with that strategy as well. What is important is that each board give these issues serious consideration.

THE DIRECTOR'S SCORECARD

I had a recent discussion with a community bank president that was very interesting. This president was explaining to me their director's scorecard. As the name implies, the director's scorecard is a way for the bank to measure the director's effectiveness in performing their director duties. The director's scorecard is really a checklist on how well the director has accomplished the goals established for them. The most interesting aspect of the scorecard discussion revolved around the established goals as it relates to director deposit and loan referrals. This particular bank established an annual goal for each director to refer $10 million in new deposits and $2 million in new loans annually. At the end of each year, part of the scorecard review process was determining how well the directors did in these endeavors. It struck me as a very effective way to review each director's individual performance. If you are looking for loan or deposit growth, you might want to consider something along these lines. The banker I spoke with said it was very effective.

THE BRANCH DILEMMA

I recently had an interesting telephone discussion with the president of a bank that is pondering the future of one of their branch locations. This bank is a smaller bank that is family-owned. The bank has two locations, the main office and a branch that was established about 15 years ago. The branch location has never really taken off. It is a great location, but has simply not produced the type of returns the bank hoped for when they established the branch.

My discussion with the bank president was what to do with this branch. The alternatives include do nothing, sell the branch, or close the branch and rent the real estate. As we were discussing each of these alternatives, the bank president mentioned to me that they would likely look to sell the bank sometime in the next ten years or so. The board believed this property, which is in a very desirable location, would make the bank as a whole much more desirable at the time the bank was put up for sale. Given that piece of information, it is unlikely the board will choose to simply close the branch and sell the property at this time.

We are going to assist the board in evaluating whether it makes more sense to continue to operate the branch location or to close the branch and simply rent the real estate until the time that the bank is sold. It will be interesting to see the pros and cons of each. I doubt either of these will prove to be a bad alternative. However, I think it is great that the bank is thinking about these strategic issues, and not making decisions from the seat of their pants.

CONCLUSION

Today is the Ides of March, soon to be followed by St. Patrick's Day. Don't forget your green on St. Patrick's Day. Look out for the green beer. We will see you again at the end of the first quarter. Have a great two weeks.

Jeff Gerrish *and* *Greyson Tuck*