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# GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Texas, Alabama, Florida, Wisconsin and Indiana!

## THE PRIVATE SERVER

Wow, have we heard a lot about “private servers” during this election cycle. Most of the discussion has not been related to banking – it has been related to one, unnamed, political candidate’s use of a private server for what should otherwise have been secure information. I read an interesting press release the other day about a community bank director who was forced to resign from his position on the board because he violated the holding company’s information security policy. His violation? He used an unsecured email server to send confidential bank information to other directors on the board. That is obviously serious business. Of course, the apparent back story on this, according to the press release, is there were “certain frictions” between this board member and the rest of the board, and this was their excuse to force him out. It sounds like a pretty good one to me. Do not make that mistake in your bank.

## IMPORTANCE OF MANAGEMENT SUCCESSION

How important is management succession? Answer: very. Every community bank should have some type of written succession plan. This should not be names scratched on the back of a napkin, but instead a thoroughly thought out and detailed plan for succession of the senior management team as well as the Board of Directors.

I was recently with a bank that had such a plan. The discussion with the Board simply involved tweaking the plan and further discussing where there might be holes in the plan. They were light years ahead of most of their community bank brethren of the same size.

### HOW FAST CAN YOU GET THE REGULATORS TO MOVE

We have been working on an acquisition transaction where the other side simply did not do their job. They failed to get regulatory approvals within the appropriate timeframe as required by the agreement. Why they did not do their job is another story, but the fact is they didn't. Their expectation was then that the regulators would jump through hoops to solve their problem of failing to get regulatory approval. It reminds me of a plaque I used to have in my office that said, "The failure to plan on your part does not create an emergency on my part."

In this case, surprisingly, the friendly federal regulator did move fairly quickly (for them). The transaction got its final approvals and will close soon. Best advice, however, is do not pin your hopes on the friendly federal regulators doing things to help you out because it is a rarity.

### THE FALLING OUT

I was recently working with a closely held bank holding company whose ownership recently had a falling out. Falling out is probably an understatement, but there were no serious crimes involved. What do you do in a situation like that? The answer is generally "the best you can." Often it means meeting individually with the parties and working for a global settlement that could result in a separation of the parties so they can each go their merry way. This could result in a sale of the bank, sale of part of the bank, a redemption of one of the parties, or any other variety of alternatives. This one came up suddenly, and we are just beginning to work through it. I will keep you all updated.

### THE DYSFUNCTIONAL BOARD

I was recently with a Board of Directors at a community bank that puts the "fun" in dysfunctional. To say this Board did not get along is an understatement. There are at least three factions on the Board desiring three different things. One faction wants to buy another bank, one faction wants to sell, and the other one does not want to do anything. As a result, board meetings, as a practical matter, are deadlocked. Little, if any, progress is made, even on the most mundane things. What needs to occur in this situation is a good dose of corporate governance,

evaluation, analysis and restructuring. This bank will not move forward until those issues get resolved.

### FDIC DATA

For those of you who are financial data junkies, you are probably already aware that the FDIC second quarter numbers came out yesterday, August 30<sup>th</sup>. Things are generally looking good and looking even better for community banks, as defined by the FDIC. The FDIC Chairman reported that “results for the banking industry are largely positive in the second quarter. Income and revenue both increased from a year ago. Loan growth remains strong.” There were fewer unprofitable banks, and problem banks continue to decline.

For community banks, as noted above, however, according to the Chairman, “their net income growth, revenue growth, loan growth and net interest margins remain appreciably higher than the overall industry.”

Anyway, if anyone wants to see the details, including the multi-colored charts and graphs, simply log onto the FDIC website, [fdic.gov](http://fdic.gov).

### EMPLOYEE DEFECTION

We recently assisted one of our community bank clients in evaluating the potential acquisition of another community bank. The selling community bank was represented by a broker and went through a formal marketing process. The broker provided a whole slew of fancy documents marketing the bank. Like every other transaction that uses this type of marketing process, all the potential acquirors were required to sign a confidentiality agreement. I have always said those confidentiality agreements are worth the paper they are written on and not much else. This “confidential” marketing process was not much of a secret.

Unfortunately for the seller, the selling bank employees found out about the marketing process. This led to a number of nervous employees, and eventually a mass defection where essentially the bank’s entire loan department left for employment at another institution. This is obviously a critical issue for the seller.

The possibility for employee defections is not unique to this seller. The way it is typically handled is to put each of the bank’s employees under retention bonus agreements, which gives them a cash payment on the day of closing. This is good, old-fashion bribery, because it makes it too expensive for the employees to leave prior to the closing of the

transaction. If you are thinking about selling your bank through a public marketing process, be sure to keep this in mind.

### DODD-FRANK IS GREAT FOR COMMUNITY BANKS!

Have you read the White House's review of the impact Dodd-Frank has had on community banks? According to the review, Dodd-Frank has provided significant benefits for community banks. If you read the report, you would think that we, as community bankers, should be praising Congress for the great work they have done in passing such an important and beneficial piece of legislation. My main gripe against the report is that it is completely out of touch! If you would like to see a copy of the report, please let me know.

### FINTECH INVESTMENTS

Over the past couple of months, I have had discussions with a number of community banks about the possibility of the bank or holding company investing in a "fintech" company. These organizations are considering these investments to partner up with fintech companies that provide what the bank believes to be a unique product or service. If you are thinking about making this type of investment, be sure you know the ground rules for doing so. They are fairly complex. It is an area that is ripe for a misstep.

If you are thinking about investing in a fintech company, or making any other type of alternative investment in order to reduce the bank's reliance on net interest income for profitability, be sure you give consideration to all of the appropriate issues. There are regulatory issues, structuring issues, safety and soundness issues and others that must be considered. We have helped clients consider all of these issues a number of times lately.

### THE REGULATORY APPROVAL PROCESS

In every community bank acquisition, the acquiror has to get regulatory approval for the transaction. The regulatory agencies that need to approve the acquisition are dependent upon the transaction structure and a number of other issues. We are currently working on a transaction that requires the approval of the Federal Reserve, FDIC and State Banking Department.

The applications required for each of these regulatory agencies are identical. We submitted each of them at the same time. The Federal Reserve and State Banking Department approved the transaction in about 30 days. The FDIC has been looking at it for the better part of

three months now, without approval. As you can imagine, this is very frustrating for us and the acquiring institution.

Unfortunately, each agency has its own timelines and method of operation. Since you cannot consummate a transaction until you have received all required approvals, it really does not matter how quickly you receive your first approval. It is the length of time to receive the last approval that matters. If you are moving forward with an acquisition, expect frustration in this particular piece of the puzzle.

### CONCLUSION

It is already the end of August, and Labor Day Weekend is upon us. The kids are back to school. I am beginning to notice a little cooler temperatures, particularly up in the northern part of the country. In the southern part of course we are seeing disruptive multiple tropical storms. Fortunately, no major hurricanes.

Enjoy your Labor Day weekend! See you in two weeks.

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*and*

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