

The



Chairman's Forum

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys

Newsletter

May 2017

The Chairman's role is always in a state of evolution. In this month's edition of *The Chairman's Forum Newsletter*, we look at some of the evolving, changing and emerging issues that Chairmen may have to deal with. Some of these deal with the way we vote on directors, how we potentially terminate directors, the use of employment contracts and severance payment provisions, and similar areas.

The point for the Chairman is to recognize that a dynamic, growing and effective organization is always going to be in a state of change. The Board's roles, duties and responsibilities, and certainly those of the Chairman as well, must change and evolve with those and your corporate documents need to keep up with that pace of change. So, we have outlined a few of those types of issues in this month's edition and we hope you will find it beneficial in governing your organization. If we can help, let us know.

Happy Reading!

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Chairman's Summary

- ◆ Don't listen to big banks.
- ◆ Review, update and re-approve employment / separation agreements.
- ◆ The bank holding company structure is still viable.
- ◆ Revisit corporate documents regarding the election and termination of directors to make sure all bases are covered.

Community Banks Should Stop Listening to Big Banks

In the past, we have warned of the dangers for community banks trying to be like bigger banks, listening to advice from bigger banks or automatically trying to emulate their processes, procedures, corporate governance and related activities. In the merger and acquisition arena, we have even gone so far as to warn community banks about conferences or seminars purportedly geared toward community banks where all of the presenters are Wall Street investment banking firms, partners out of the largest firms along the east coast and sponsored by organizations less than friendly to community banks.

Apparently in a “coming out of the shadows” strategy, a recent headline touted “JPM Encourages Community Banks to Merge”. It was stated that JPMorgan Chase had advice for community banks under \$50 billion in assets. That advice was “merge while you can”. The article indicated that, according to a Bloomberg report on a recent JPM presentation to their depository clients, JPM warned that the Federal Reserve’s policy normalization could drain the banking industry of deposits and, therefore, community banks would or should engage in merger transactions or otherwise sell. Thanks for the advice, JPMorgan, but for “normal” community banks around the country (we do not know of any \$49 billion community banks), a strong focus on enhancing stockholder value, providing liquidity and dividends to stockholders and maintaining the organization’s overall safety and soundness will continue to promote viability as long as the bank desires it. Community banks will not sell out just because a large bank thinks they should. The Chairman should continue to be the strongest advocate for independence where it continues to promote the best interests of the stockholders and your communities.

Employment / Separation Agreements May Not Matter

As a Chairman or key executive officer of your organization, you may be responsible for the implementation of employment contracts, change in control payments, severance agreements and other types of executive compensation arrangements. You may even have those types of documents for yourself. However, the mere fact that there is some type of contractual obligation that looks formal between the parties, negotiated at arm’s length

and filled with plenty of “lawyer talk” may not always hold up depending on the circumstances.

Take for example the recent case of a CEO fired from a Chicago-area bank. After her termination, she filed a lawsuit claiming her dismissal was tied to her gender and claimed that the bank cut her salary before she was fired and refused to pay her any severance, even though she had a severance agreement. But consider the bank’s retort. The bank indicated it terminated her not for gender discrimination, but because of her poor performance, the fact that the bank was placed under a cease and desist action and that they refused to pay the severance because it was deemed to be a “golden parachute” and the FDIC does not permit executives to “parachute out” of an institution where the leader arguably caused some of the problems. So, the mere fact that the executive had an employment contract that provided for severance payments did not guarantee that the executive would receive those payments. We have seen many circumstances over the years where the executive has sued an organization to recover payments under the severance agreement only to find that the payments are prohibited by the organization’s regulatory agency.

Also, if you have employment contracts with non-compete provisions, keep in mind that those types of provisions generally are not favored by courts unless they happen to be fairly limited in duration and geographic area. So, for example, if your CEO has some type of employment contract that, upon termination, provides for non-competition, and the duration of the non-compete is for three years and the scope is anywhere in your home state or any contiguous state, that would likely not be upheld. However, a one year limitation on competition within a certain geographic radius of the bank

or within the county or something more restrictive might be more likely to be upheld. If your organization has a number of different types of contracts in place that have not been reviewed and updated in a while, it is normally beneficial to have those reviewed, updated and re-approved by both parties rather than allowing them to simply renew on an automatic basis year after year without anyone paying attention to them until they become a problem.

Remembering the Bank Holding Company

Recently, we saw a news story about an organization that was considering a strategic move to dissolve its bank holding company. The alleged reasons for making this move were argued as cost cutting and improving efficiency. We disagree with that conclusion and think occasionally the Chairman and the senior leadership should revisit the importance of the bank holding company, remember why it was put in place and strategically plan ways to utilize it for the benefit of the organization rather than merely having it as a forgotten shell entity.

Among the key reasons to have a bank holding company include the ability to use it as a source to borrow funds to supplement tier 1 capital at the bank level. This allows the bank to increase its capital without causing dilution to stockholders by issuing more stock to new individuals or by asking existing stockholders to pony up more money in order to maintain their current ownership position.

Additionally, the bank holding company should be used as the primary source of getting liquidity to stockholders desiring to sell shares. Unlike a bank-only structure, the holding company allows for the acquisition of shares from individuals without the necessity of amending stated bank

capital, seeking prior regulatory approval in most cases or getting shareholder approval. Therefore, it is an efficient manner of creating liquidity through repurchase transactions for stockholders who need or desire liquidity.

In the merger and acquisition context, almost all deals are done through a bank holding company because of the manner in which it facilitates the acquisition of other entities, creates more favorable tax structures, may allow a buyer to maintain the separate charter of the target institution and other benefits.

The bank holding company structure also improves overall operational efficiency and effectiveness. The ability to have a separate and distinct Board of Directors at the holding company level and the ability to “promote” directors to holding company level status also may improve Board succession planning at the bank level. Having stockholders own stock at the holding company level as opposed to the bank level also improves organizational operations because most corporate statutes allow for stockholder approval by a majority rather than a two-thirds vote and allow the organization to put in place more favorable types of corporate structures such as anti-takeover mechanisms.

So, we believe the bank holding company structure is still viable and would not recommend any organizations terminate their holding company status. Moreover, for those institutions that have still not yet pursued a bank holding company structure, we would highly encourage you to get more information from our firm or other sources about the benefits of that structure and how it can help your organization.

Election and Termination of Directors

There are some emerging issues in corporate governance related to the election and termination of directors. These may require your organization to revisit your corporate documents in more detail to understand exactly what procedures you have in place or what steps you need to take to clean up your documents.

The first issue is the vote that is required to elect directors. The answer that may come to the top of your mind is that it is a simple answer, directors are elected by a majority of the shares. However, in most cases, that is not accurate. In most cases, directors are elected by a “plurality” vote. That means the directors who receive the most votes (regardless of whether it is a majority of votes) are elected. For example, if three directors are up for election, the three directors on the ballot (and normally there are not even more than three) who receive the most votes (regardless of whether those votes constitute a majority of the shares) are elected as directors. But in some recent, more contentious stockholder meetings of large public institutions, there has been a continual push to improve corporate governance to require directors to receive the approval of a majority of all shares in order to be reelected. For large organizations, that can bring in a host of issues dealing with proxy solicitation, institutional investor votes and related concerns. In a smaller bank, if it were to require a majority of shares to approve a director, then one or two families or one or two individuals might be able to control who is or is not elected to the Board. So, while this emerging trend away from plurality voting to majority voting for larger organizations seems to be occurring, it probably does not make much

practical sense for smaller banks, but it is something you should keep an eye on.

The second issue has to deal with termination of directors. If you need or want to remove a director from the Board, how do you do that? We have found that most organizations do not know the answer to that until the situation presents itself and often times the Board is surprised to find there are no easy answers. For example, can a director be terminated without “cause”, or can a director only be terminated for “cause”? If a director can only be terminated for cause, what constitutes cause? We would all easily recognize that embezzlement, being convicted of a felony or something egregious would constitute cause and we would all acknowledge that something non-egregious, like receiving a speeding ticket, would not constitute cause. But what about the more gray areas? What if a director receives a DUI conviction? What if a director is Chairman of a political party and constantly makes disparaging comments about the other political party in the local press and news? Does reputational damage to the organization by a director constitute cause?

Those are the types of areas that might need to be revisited before there is actually a concern. If a director may be removed without cause, can that be done by a simple majority vote of the Board, does it take some type of supermajority vote and can the Board itself even be permitted to remove a director who has been elected by the stockholders? All of those are emerging types of issues for Chairmen and the Board as a whole to consider and the organization might be prudent to revisit its corporate documents to make sure the organization has all of its bases covered in the event something unusual were to happen.

Meeting Adjourned

The Chairman of the Board is certainly an evolving position and in this month's edition of *The Chairman's Forum Newsletter*, we showed some of the new and emerging trends and issues for Chairmen to think about. If we can be of assistance in helping you consider any of these, please do not hesitate to contact us.

Until next time,



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