GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Wisconsin, Minnesota, Illinois, Tennessee, Pennsylvania, and West Virginia!

TRANSACTION NEGOTIATIONS

The past couple weeks have been particularly busy in negotiating acquisition agreements. For some of these we are representing the buyer, and others we are representing the seller. These past couple weeks have been a reminder that there is no "standard" for community bank acquisition provisions. Instead, you truly get what you can negotiate.

In each of these instances, we are negotiating specific provisions of the agreements relative to the facts and circumstances of the situation. In a couple of these the outcome of the negotiations are direct opposites of one another. For example, in one circumstance the purchaser is paying the deconversion fees for the data processing conversion. In another, the seller is paying those fees.

If your community bank is contemplating getting into the acquisition game either as a buyer or a seller, keep in mind that none of the provisions in the agreement are immune from negotiation. The important thing is to figure out what is important to your community bank in the transaction and then figure out what it is that your community bank can take and what your community bank is going to have to give in exchange.

DIRECTOR LIABILITY

I was recently in a meeting with a board of directors to discuss the potential establishment of an ESOP or KSOP. One of the directors questioned whether it might be "safer"

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from the board’s fiduciary standpoint to go with an ESOP instead of a KSOP. The director wondered whether the employees’ ability to decide whether to invest in the company by redirecting a portion of their 401(k) funds to the purchase of holding company stock exposed the directors to additional liability.

My answer was that the KSOP, for all practical purposes, did not present any additional risks to the directors. Instead, as a practical matter, a director’s liability is pretty much fixed relative to the value of the investments in regards to all shareholders. The director does not have any greater liability for his or her decisions as a director because the board has decided to establish a KSOP and give employees the opportunity to invest. Instead, the risk is simply a disclosure risk.

If employees are given an opportunity to purchase shares through a KSOP, the biggest risk is disclosure risk - have all the material risks been disclosed to the potential purchasers? That is a much more pertinent issue in the overall risk analysis than is the risk of breach of fiduciary duty by a director.

MATERIAL DISCLOSURES

We are currently assisting a number of different clients in drafting disclosure documents related to the private placement of bank holding company securities or the repurchase by the holding company of those securities. Some of these documents are for the sale of common stock. Others relate to stock repurchase programs. One question that often comes up in drafting these types of documents is whether any specific item needs to be disclosed.

As a practical matter, when it comes to securities law, if there is a question about whether certain information needs to be disclosed, the answer is generally “yes.” For many stock offerings and share repurchase programs, particularly for non-SEC reporting companies, there are no hard and fast rules on what must be disclosed. Nonetheless, the disclosures should include anything that may be material to the shareholders’ investment decision. As a general rule, we have found that if you are asking about whether it might be material, then it probably is.

In any sort of securities or share repurchase documentation, always err on the side of caution. The community bank holding company puts itself in a much better situation if it discloses something that is ultimately not material than if it fails to disclose something that is material.

THE FAMILY OWNED BANK

There are many, many family-owned banks in the United States. We have had the opportunity to work with a couple of good ones in the last few months. The question that rightly comes up for these banks is “how do you keep the family-owned bank independent and pass it on to the next generation?” Obviously, issues of ownership transition and management succession are paramount here. With respect to most family-owned banks, the current ownership has a strong and steady hand toward leaving the bank independent. The struggle, of course, comes with the transfer of the bank holding company stock to the next generation. Other times, that generation is either not interested in working in the bank or, more likely, simply has their eye on a large, illiquid asset that could be liquidated (and spent).

The bottom line is these family-owned banks need to make the stock so attractive to the next generation that they will want to hold onto it. This generally means cranking up the cash flow.

REGULATION O LOAN APPROVALS

We were recently assisting a client in the due diligence process for the acquisition of a community bank. As part of the process, we reviewed all of the board minutes from the past couple years. We also reviewed the loan files for various loans, including all Regulation O loans. What struck us as particularly odd (and a little troubling) about this bank is that neither their board minutes nor their credit memos for Regulation O loans have any analysis of Regulation O and how the loan complies. We view discussion and documentation of this type of information as more than a best practice within the loan approval process.

Any time your community bank makes a Regulation O loan, our recommendation is that both the credit memo and the board minutes disclose how the loan complies with Regulation O. The regulators expect this type of analysis to be completed on every Regulation O loan. Documenting the analysis also shows the regulators, potential acquirers, and anybody else with a similar interest how the loan complies with Regulation O. It is not much additional work, but the failure to include that information certainly raises a number of different alarms.

BANK LIQUIDITY

The *American Banker* (the daily scandal sheet) ran an interesting article recently on regulatory concerns with respect to bank liquidity (if anybody wants a copy, let us know). The article dovetails somewhat with a couple of recent inquiries we have received from clients with respect to regulatory criticism of bank liquidity. As usual, the regulators are trying to get out in front of what they anticipate will be a problem for banks that are using significant non-core sources of liquidity. It has really not mattered much in the past because all community banks were flush with deposits. However, the regulators anticipate as the rates rise that deposits will chase rates and those "surge" deposits will surge their way out of the bank. Is the concern legitimate? It may be, depending on the bank's contingency funding plans, risk management practices, and risk tolerances.

This appears to be a refreshed regulatory hot button, and unfortunately, regulators do have long memories. They remember that many of the banks that failed during the last recession were funded with other than core funding. If there is another "black swan" event, i.e. a total collapse of the commercial real estate market or the Ag market or whatever, their concern may be legitimate.

WASTE OF TIME

I was visiting with a new client recently about facilitating their long-term planning session. They indicated they had used an outside facilitator for their last session, and while the session went fine, the follow up from the session was sorely lacking. There was no report on the session, as a practical matter, and no action plan to enable the board to provide accountability for the strategies established. This particular CEO complained that he felt because there was no action plan and accountability that the whole process was a waste of time. I couldn't agree more. One of the tenants of planning is that not only does the board and management team need to establish strategies to form the basis for management's operational and tactical planning, but the plan also needs to build in accountability for those responsible for executing on the plan. If there is no accountability for what is discussed and determined at the planning session, there is no sense in having a planning session. It is, in fact, a waste of time.

Our general recommendation for accountability is that the board at each monthly meeting set aside time for forward-looking strategic and risk discussions. If you have a strategic plan and a plan document and an action plan, include that at least quarterly in your strategic discussions. That way it will provide accountability for those responsible for executing on the plan.

DE NOVO BANKS

As most of you know, there have been very few new banks (de novos) formed since 2008. Actually only a handful. We are beginning to see a little uptick in activity with respect to filings with the FDIC for deposit insurance for new banks. Our firm is also getting numerous inquiries from former bank directors who sold their bank or otherwise do not have a community bank in their town with respect to de novos. Our consulting and law firms are in the de novo bank formation business. If you know anybody looking to charter a new bank, particularly in an area where consolidation has occurred among the community banks, please send them our way.

CONCLUSION

As all of you know, tax day is right around the corner. Please consider this a friendly reminder to make your annual contribution.

It appears spring may finally be springing up in most parts of the country. Thank goodness. Have a great two weeks.

Jeff Gerrish *and* *Greyson Tuck*