GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from New York, Arkansas, Minnesota, Washington, Louisiana, Texas, and Florida!

THE BEST PLACE TO WORK

Eighty banks were recently announced as the "Best Place to Work." A number of Gerrish Smith Tuck clients and *Musings* readers were among those top 80 banks. The consistent theme in those banks is that they put their employees first, there is a culture of engagement, and they have a strong value system. Congratulations to all the banks that were on the list, and congratulations to those of you who are striving to get there.

LIQUIDITY REALLY MATTERS

Our firm's mantra is that the fundamental duty of community bank directors and officers is to enhance shareholder value. Although that sounds like a very "consultant" term, it really means growing earnings per share, providing an appropriate return on equity, providing liquidity for the stock, (which is the ability of the shareholders to convert their shares to cash at a fair price in a timely manner), and paying dividends or dividend-equivalent distributions.

We recently met with a board of directors for a very well run and profitable bank. We were in this meeting because the board had received an offer for the purchase of the bank and brought us in to assist the board in considering the offer and determining how best to respond.

The meeting reiterated for us that share liquidity matters! This is because during what was essentially the thumbs-up or thumbs-down vote on whether they ought to move forward with the sale of the bank, a couple of the directors indicated that they hated to see the bank sold, but the fact that they had no real liquidity in their stock essentially made a sale of the company the best option.

We have harped on it for years, and we will continue to do so. Providing liquidity for the common stock is a fundamental duty, and the failure to do so is a real threat to independence. The various ways liquidity can be offered is beyond the scope of this brief *Musings*, but let us know if you would like to receive more information on how to create liquidity for your bank holding company shares.

EMPLOYEE ENGAGEMENT

In the last *Musings* we requested any suggestions anyone had with respect to employee engagement, including use of bank products and services, as well as deposit accounts. A number of you provided suggestions. I have summarized some of those below.

- Running contests where employees that make a specified number of bill pay transactions in a quarter, convert to e-statements, etc. are entered into a drawing for a gift card or paid time off.

- Requiring employees responsible for a product to use it themselves.

- Incenting employees to use products, such as, having random drawings for $50 for employees who use the bank's electronic products.

- Opening a checking account for employees when they are hired and requesting they use the bank's own mobile app or internet banking to keep up with transactions on this account, which helps to train them on the bank's services.

Any *Musings* readers with anything additional and creative, please forward it on.

THE STRATEGIC PLAN THAT WASN'T

Some time ago, I facilitated a planning session for a bank in a very rural community. It was a good bank but on the small side. The bank was doing business pretty much the way it had always done business. In the planning session, I suggested a number of different strategies they may execute that would really improve that bank and its place in the market. Both the senior officer group and the board were enthusiastic with respect to the strategies.

On one of my tours around the countryside, I drove through that town again. While I did not have time to stop, I did reflect on that planning session and the action plans that came out of it. I contacted the CEO of the bank and found out, unfortunately, that nothing had been done. Although the board and management had bought in to the identified and established strategies and assigned the action plans, there had been no leadership from the top. Daily business got in the way, and nothing had been done. I view that as the strategic plan that wasn't. The fortunate thing is that most of the strategies were not time-sensitive and could be implemented at this point if there is enough motivation to do so. I hope there will be.

FAMILY-OWNED BANKS

We have the opportunity to work with numerous family-owned community banks across the United States. As we have mentioned in *Musings* before, often with a family-owned bank it is important to understand where the family is coming from before the strategies for the bank are determined. We have had several recent meetings with various family-owned banks where we have met first with the family and then, once certain basic issues were identified (such as independence, organizational structure, sale of shares, and the like), with the senior management and full board of directors. It generally provides for a much more effective planning session when the family realizes that it is on the same page going into the session on certain major strategic issues. Once consensus within the family is established, then the direction can be tweaked with input from senior management and outside directors.

EXAMINER COMMUNICATION

During a recent telephone discussion with a long-time client, I heard what is a first for me. It involves examiner communications. No, it is not communications between the bank and the regulators. Instead, it was communication between the regulators themselves through multiple examinations.

In short, this client was undergoing a state examination. One particular loan in the bank has been a watch list loan for some time. However, the loan has paid as agreed for a number of years. Notwithstanding the payment history, the state examiner indicated the loan was going to be classified substandard. When our client objected, the state examiner essentially pointed to a note in the file left from the federal examiner 18 months earlier. The note in the file essentially said that if the loan did not show any improvement in 18 months it should be classified substandard.

We are sure you can imagine our client's frustration. The federal examiner 18 months ago essentially passed the credit but made a determination to classify it 18 months later if there was no change. We take exception to this line of thinking for a number of reasons, the most obvious of which is the state examiner should review the loan on its merits at the time of the examination. We do not believe the federal examiner should pass a credit only to say that if the credit is in the same situation much later it should be substandard.

Our client bit his tongue on this particular issue because it did not make a material difference to the results from the exam. However, it did not sit well with him, and we can certainly understand why.

REGULATORY SCRUTINY ON BANK LIQUIDITY

Speaking of examinations, the regulators continue to focus heavily on bank liquidity issues (not share liquidity, as noted above). We have seen many Reports of Examination recently where community banks are getting somewhat beat up over liquidity concerns. The regulators are particularly focused on what they consider potentially volatile funding sources. Case in point: We recently reviewed a Report of Examination containing a liquidity ratio we had not seen before. This particular Report of Examination measured this bank's "aggregate potentially volatile funding sources concentration ratio."

Other than being a federal regulatory mind-numbing mouthful, the aggregate potentially volatile funding sources concentration ratio is a liquidity ratio designed to monitor funding concentration risk. Essentially, this ratio takes into account any funding source other than core deposits that accounts for more than 10% of total liabilities. The ratio then compares the aggregate of these concentrated funding sources to total liabilities. Obviously, the lower the number, the better in the examiner's eyes.

As we have mentioned previously in *Musings*, we have seen the importance of liquidity and deposits come back strongly since the beginning of the year. Based on the discussions we are having with banker, we expect this to continue. If you have an excess of liquidity in your bank, be glad you are not out there fighting for deposits because it is tough. Also, however, realize that makes you a target for an unsolicited offer because many acquirers are looking fondly upon banks that have an excess of liquidity.

STRATEGIC PLANNING

As many of you *Musings* readers know, we facilitate dozens of strategic planning sessions for community banks each year. As we head into September, we are beginning what we fondly refer to in our firm as the planning session “busy season.” Many boards choose to hold their planning sessions in the fall so they can plan for the next year.

I recently was discussing our approach to strategic planning with a new client. My comment was that strategic planning can essentially be broken down into three basic components. First, the whole point of strategic planning is to adopt action items to enhance shareholder value. Second, the preliminary determination in an effective strategic planning session relates to independence. We recommend you determine whether you are a buyer, seller, or neither, because the answer to this question has a significant bearing on the future strategies for the bank. Finally, we recommend you identify your basic business strategy, which is a focus on profitability, asset growth, or a combination of the two. Once you have identified these major issues, the next step is to fully discuss and attempt to reach consensus on decisions to achieve these overarching goals.

If you are preparing for your strategic planning, keep these three primary issues in mind. We think it the most beneficial use of your directors’ and officers’ time and efforts as it relates to strategic planning.

We have quite a few materials in our firm on appropriate community bank strategic planning. Please feel free to contact any of us if you would like to receive information on this important aspect of corporate governance.

PARALYSIS BY ANALYSIS

We have recently been working with multiple clients to analyze and create bids on banks that are for sale. Our general method of operation is to run the financial analysis, make some assumptions, make some adjustments, and come up with a ballpark range that we think would be a good value of the target bank to our client - that is, one that enhances shareholder value post-transaction (assuming execution goes well). Occasionally, we get clients who are involved with what can best be described as “paralysis by analysis.” In other words, they have to keep analyzing and analyzing and analyzing to make sure that every assumption is achievable simply to submit a nonbinding bid. We understand a bank that wants to make sure it is doing the right thing, but we also think that an acquiror cannot possibly wring 100% of the risk out of any transaction. We suggest saving the "paralysis by analysis" for later in the deal when the bank is actually talking about a binding agreement. Just a thought.

MERGER AND ACQUISITION WORKSHOP

As *Musings* readers know, our firm provides financial advisory and legal services in connection with merger and acquisition activities. Over the last several years, the three of us have also conducted a Merger & Acquisition Workshop sponsored by the Independent Community Bankers of America. Another Workshop will be held on October 29th and 30th in downtown Nashville, Tennessee. This is a very hands-on workshop and is perfect for those banks that are contemplating getting in the acquisition arena, either as buyers or sellers. It is not for big banks. It is for community banks - to help them understand not only the process, but the issues. The Workshop is ideal for CEOs, CFOs, and outside directors, or members of the Merger and Acquisition or Strategic Committee.

The link to the registration is set forth below. We hope to see you there.

Mergers & Acquisitions

CONCLUSION

We are all looking forward to a relaxing, family-friendly Labor Day Weekend. We hope you are as well. Keep in mind that post-Labor Day virtually all the schools are in session (even those up North). Watch out for the kids. Be safe and have a great weekend.

See you in two weeks.

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