

The



# Chairman's Forum

*Opening the door to new ideas*

**Newsletter**

**Gerrish Smith Tuck, Consultants and Attorneys**  
*September 2018*

During the fall many organizations have their strategic planning sessions. In our travels around the country, as we are kicking off the fall, we are seeing a number of interesting issues come up from Boards of Directors and management groups. In this month's edition of *The Chairman's Forum Newsletter*, we look at a few of these issues that we think have some universal interest and provide some thoughts and insights on how, as Chairman of the Board, you might consider these various issues to improve your overall Board governance and drive value for your organization.

We hope you find this information helpful and interesting, and if you have questions or comments, do not hesitate to reach out to us.

Happy Reading!

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## *Chairman's Summary*

- ◆ Should you consider an anti-takeover plan?
- ◆ Is a cap on comp the right way to go?
- ◆ Is your Board afraid of debt?
- ◆ Don't sweat management succession.

## *Does My Bank Need an Anti-Takeover Plan?*

As the merger and acquisition market continues to pick up steam, many of our clients find themselves dealing with the question of whether they are going to sell their bank, even though there is really no desire to sell the bank. Almost always, when we facilitate strategic planning sessions, we think it is incumbent upon the Board of Directors to openly and honestly address the question of "Should we sell the bank?" We always hope the answer is a resounding "no," but if there is no desire, the question then becomes how the organization can position itself to avoid being acquired. There are a couple of key factors that come into play which, as Chairman, you should keep in mind. We have outlined a few of those below.

We often start with the question to the Board of Directors of whether they believe they could ever have a fiduciary obligation to sell the organization. In essence, could there be a legal requirement to sell the bank? Interestingly, the answer is yes. Stated in a simplified fashion, if a Board of Directors is being offered something from a potential purchaser (stock, cash, or a combination) that is a substantially better deal for your stockholders than continuing to hold the stock of your organization, then certain fiduciary obligations would suggest that there might be an obligation to accept the offer. So, one of the first and best anti-takeover defenses is to continue to run your organization on a daily basis as though it is never going to sell, continue to focus on maximizing shareholder value, and make your own stock so attractive to investors that no one will want to sell and no purchaser could really afford to buy you. In other words, you can “earn your independence”. In taking that approach, various strategic initiatives come into play because an institution that finds itself as a likely target, might decide it needs to be taking steps to make its stock more liquid, it may need to increase dividend payouts, it may need to focus on the expense side of the income statement to improve efficiencies, and other strategic endeavors.

Beyond just making your organization a better performer, on its own, in some cases it might be appropriate to adopt a formal anti-takeover plan. That is normally accomplished by making specific amendments to the Articles of Incorporation and Bylaws of the holding company and/or bank to place certain impediments that make it more difficult for purchasers, slow down the overall process, or at least force a potential purchaser to deal with the Board of Directors and not individual stockholders. If done right, those types of items would not prevent an organization from selling if it wanted to,

but it would certainly deter an unwelcomed suitor. Some of those types of key components are technical in the sense of eliminating preemptive rights, removing cumulative voting requirements, limiting the ability of stockholders to call a special meeting, and similar factors. However, others are more holistic in their approach, such as amending your Articles and Bylaws to specifically delineate the factors that the Board of Directors is required to consider when looking at any acquisition opportunity. Typically, those requirements indicate that the Board must consider things beyond just the price being offered. Those items might include the reputation of the buyer, the impact on the community, the effect on the Board and management, any change in incentive compensation, the likelihood of changes in products and services, and other factors. The best way to accomplish that is to have stockholders vote to amend the Articles of Incorporation to add those items so that the Board can validly and appropriately consider all such alternative factors in an acquisition context, with the full endorsement of stockholders.

Interestingly, we have also seen a somewhat odd development in M&A activity that is sometimes considered an anti-takeover mechanism where a potential seller has tremendous amounts of termination penalties in their data processing contracts or other vendor contracts. Sometimes, upon due diligence, a buyer may find the total cost of terminating the various contracts to be so excessive that they simply walk away from the deal or negotiate a price-down substantially. So, somewhat ironically, a ten-year data processing contract with a huge termination penalty may, in and of

itself, be an anti-takeover mechanism. However, we do not recommend signing a long-term data processing contract just for those purposes and, on the contrary, we recommend keeping those contracts as short as possible if you think there is any likelihood your organization may sell in the near term.

### ***Should We Put a Cap on Comp?***

How much money should your management team make? What types of compensation should they receive? Typically, we would advise that an entire compensation package should include base salary, some component of incentive compensation, and some form of equity-based compensation. But, is it ever possible to reign in the compensation? We have encountered a number of organizations that, in addition to whatever typical compensation they may provide, those organizations also provide, almost as a matter of course, yearly cost of living adjustments or something similar. What happens, though, is that in doing so that additional amount paid each year begins to be viewed by the employees as just another part of their salary and they feel as though they are guaranteed to have a higher base salary each year regardless of their performance.

A Board of Directors might rightly be concerned with no cap on that practice that the total compensation numbers for the organization will become disproportionately high. However, we often caution Boards of Directors not to begrudge a well-paid management team. That is the directors' best defense against their own liability concerns by having a well-paid management team that knows what they are doing and who are running a safe and sound organization. In addition, directors must specifically avoid the process of comparing salaries. We have often heard Board members talk

about how much the CEO or some other officer is making and make a comment to the effect that the director never made that much money when he or she was that age or something else that is irrelevant.

The area of compensation is always a sticky one, and our recommendation is not to try to make decisions in secret. If the Board wants to change the compensation structure, they should be open and honest with the management team and perhaps even engage the management team in coming up with ways to overcome Board concerns and yet still adequately compensate management. Do not let compensation structures automatically be a top-down directive from the Board. Engage the management team in the process.

### ***Is My Board Afraid of Debt?***

With more prosperous economic times at hand, organizations are experiencing healthy asset growth and increased profitability. However, sometimes the asset growth is out-stripping the net income's ability to supplement capital and we may find capital ratios declining. So, would your Board be willing to take on debt at the bank holding company level to push down to the bank in the form of new capital? Or, alternatively, if your capital ratios are somewhat "thin," would you be so fearful of taking on debt at the holding company that you forego engaging in a positive transaction such as a stock repurchase transaction or making an acquisition?

As Chairmen, we think it is appropriate to engage your Board in a discussion of their risk tolerance related to how much debt the organization would be willing to take on for any particular transaction or to supplement capital. Some organizations even find it helpful to establish a line of credit

with a correspondent lender to have ready access to liquid funds anytime there is a need, so consider whether that type of strategy might be appropriate for your organization as well. The bottom line is that the organization's overall risk tolerance certainly involves capital as well, and a healthy discussion about whether the organization would be willing to take on certain levels of debt we think is paramount for all organizations.

### ***Don't Sweat Management Succession***

At what point should a Chairman, Board and management begin a management succession process? Ironically, for many Boards of Directors, the process begins only when there is actually a position to be filled. Obviously, more diligent Boards of Directors make management succession part of the strategic planning process and are concerned about ensuring strategic plans for emergency management succession needs as well as longer term grooming of candidates for management succession.

However, we often see Boards struggle with exactly how and when to initiate a succession planning process and which parties to involve. For example, should every organization have an heir apparent named and written in its strategic plan for the position of CEO? That certainly sounds logical on its face, but what if your CEO is in his or her early 50s? If they plan to work another 15 years, do we need to name a succession candidate currently? In those circumstances, we often think the best approach is not to sweat the specifics of naming individuals for management succession, but to ensure that you do, in fact, have a protocol or a process in place of how you would handle an emergency management succession issue. Furthermore, while we do not think you necessarily need to tap an heir apparent who is

likely going to take over in 10 to 20 years, your management succession process might very well designate the structure for certain succession items such as indicating that, on an emergency basis, the organization would be run by a committee of three designated individuals for a period of time, the Board would meet and appoint an individual from a certain category of officers (for example, executive vice presidents) who would run the bank on an interim basis or something similar.

So, we think the bottom-line is that every organization needs to outline an emergency management succession plan, protocol or course of action. In addition, if your CEO is within three to five years of retirement age, it would likely also be appropriate to begin grooming candidates, hiring individuals from outside the bank or taking other steps to ensure that a smooth transition takes place. However, if your CEO or other key officers still have many years left until retirement, perhaps do not sweat management succession and feel as if you have to have an heir apparent already named.

### **Meeting Adjourned**

As we move into the Fall, keep your Board and management engaged, keep looking for new ways to drive stockholder value and please let us know any time we can be of service.



Finally, we are very pleased to announce that we have established a date, time and location for the next Chairman's Forum Conference. On January 17 and 18, 2019, we will be hosting another Chairman's Forum at the beautiful Ritz-Carlton Hotel in Naples, Florida. We encourage each of you to attend perhaps along with other key lead directors, your senior management or other individuals. As many of you know, this is a one of a kind, unique open forum discussion for Chairmen of the Board and others from across the country where ideas can be exchanged, best practices discussed and it is our privilege to facilitate those discussions. Registration materials will be available soon, but if you would like for us to go ahead and hold your spot please email Carolyn Martin at [cmartin@gerrish.com](mailto:cmartin@gerrish.com) and we will hold a slot for you and provide you registration materials as soon as they are available. We look forward to seeing you all in Naples.

Until next time,



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**HOW TO CONTACT US:**

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