GERRISH'S MUSINGS

Jeffrey C. Gerrish
Philip K. Smith
Greyson E. Tuck
Gerrish Smith Tuck
Attorneys/Consultants
700 Colonial Road, Suite 200, Memphis, TN 38117
♦ Phone: (901) 767-0900 ♦ Fax: (901) 684-2339 ♦
♦ Email: jgerrish@gerrish.com ♦ psmith@gerrish.com ♦ gtuck@gerrish.com ♦
Website: www.gerrish.com

March 29, 2019, Volume 389

Dear Subscriber:

Greetings from Georgia, South Carolina, Tennessee, Minnesota, Wisconsin, and Illinois!

ATTRACTING AND RETAINING MILLENNIALS

We were recently in a discussion with a number of community bankers with respect to attracting and retaining millennials. One banker indicated that they have a video game day each week. (We guess they are still called "video games".) This allows the millennials, or anybody who wants to participate, to go into the breakroom and play video games for their lunch break. For whatever reason (ones that we really cannot understand) this is an attractive feature to the millennial group. Just a thought.

DEPOSIT GATHERING

At a recent roundtable discussion with a number of community bankers, the topic turned to deposit gathering. These were bankers from various parts of the country. Interestingly, some of the banks were at a 100% loan to deposit ratio or more, and deposits were essential. Others had more deposits than they knew what to do with, but not enough loans. It really varied significantly by part of the country and rural/urban issues. Unfortunately, no one had a silver bullet as to how to gather deposits. Suggestions for increasing deposits included a) incenting loan officers to bring deposits, b) penalizing loan officers for not bringing deposits, and c) hiring deposit gathering individuals solely for the purpose of finding deposits. Most of the younger lenders have never been in an environment where they needed to find deposits to fund the loan portfolio. For most of them, they are now. They need to understand that it requires a different skillset and a different focus.

WILL HISTORY REPEAT ITSELF?

A number of the banks we have been in in the last month or so have found themselves with fairly significant concentrations of commercial real estate. Most of those banks, while at or above the "guidelines" established by the regulators, reasonably believe that they are managing the concentration risk in commercial real estate appropriately. Unfortunately, about half the lenders (i.e., the young ones) have never been in a down commercial real estate market, since we are nearly 10 years away from it. We need to keep a close eye on our asset quality. Those of you who recall the last recession, it was basically the result of the asset quality snowball. This is simply where asset quality becomes impaired, resulting in impaired earnings, which results in a failure to augment capital, and ultimately leads to a conclusion that management is no longer competent. Let's avoid that this time around.

BACKGROUND CHECKS

As most of you know, anytime a regulatory application is filed these days, unless the individuals involved are "known to banking," the individual(s) - whether a new board for a de novo, the change-in-control participant, or otherwise - must go through the regulatory background check. This is not simply a background check by your friendly federal regulator. It is a background check with the full resources of the United States Government, including all the intelligence agencies, drug enforcement, NSA, and others. Everything is uncovered, plus some.

We have been working on a number of transactions recently where background checks were being required for a number of individuals. It is not unusual for the background check to reveal something the individual did not disclose on their federal form. This is not a deal breaker, but it is somewhat embarrassing. Most of the time this involves an old action - a tax lien or something else. It may even involve mistaken identity.

The bottom line, however, is if you are going to fill out a federal form, generally an "Interagency Biographical and Financial Report," please make sure you do it accurately.

THE UNSOLICITED OFFER

As we have noted in *Musings* previously, unsolicited offers in the current environment are becoming more prevalent. These are simply unsolicited, not hostile. One problem with an unsolicited offer from the target's standpoint is that it burns up a lot of board time talking about the "what ifs."

Keep in mind, the board's job is to decide whether to move forward with an unsolicited offer, to keep the status quo, or to put the bank in play as a result of the offer. The offer does not go to shareholders unless the board recommends it.

The real test for an unsolicited offer is whether the shareholders of the target are better off holding what is being offered or holding their own stock. This generally requires a financial analysis often by an outside third party to provide some support for the board's decision. For a number of our clients who receive regular unsolicited offers and do not like burning up the board time, we have created an Unsolicited Offer Policy. This policy basically provides that if the offer is not from a "credible" source (i.e., one that can get a deal done) and is not at a "credible" price (i.e., above some predetermined benchmark established by the board) then the board can simply reject it out of hand. This saves a lot of time and angst in board meetings.

THE CARROT AND THE STICK

We were recently asked to review a retention bonus agreement. This agreement is to be presented to various employees of a community bank that is being acquired. We are not representing the employees, so we are merely an observer in the process. However, the structure of the agreement was, in our opinion, noteworthy.

As is indicated by the title, this agreement was both a carrot and a stick. The carrot was the retention bonus payment that the employees would receive assuming they stayed on for a certain amount of time after closing. The stick was the various non-competition, non-solicitation, and similar provisions that the employees would sign up for by choosing to receive the bonus. This target bank did not have any type of agreement that had these other provisions, so the employees were giving up something in order to get the benefit of the retention bonus payment.

This is an interesting dynamic for these employees. The central question is whether the payment is going to be enough to entice them to agree to the restrictions contained in the agreement. This is not unlike any other employment agreement, it is just a little bit different setting and documentation.

EARLY INDICATORS

Over the past six weeks or so, we have started to hear much more discussion about the next recession. It seems that many community bankers are thinking that we are near the end of the cycle and at some point in the not too distant future we will begin the downturn into a recession. We have recently heard from a community bank president that was less than enamored with the characteristics of the loans and applicants that had been presented recently. Another community banker has mentioned they have seen their 30-day past dues creeping up. Are these early indicators that a downturn is coming, or are they just one-off comments that do not make a trend? Time will tell.

Whether these comments are tea leaves as to a recession is really not the point. What is important is that you figure out the asset quality tea leaves and leading indicators in your bank and keep a close watch on them. Whether it be loan applications, 30-day past due loans, or some other factor, the early identification of asset quality problems is of utmost importance to enterprise risk management. We have always believed anyone can be a great banker if they can figure out how to identify, monitor, measure, and control risk. We also fully realize that is much easier said than done!

EMERGENCY SUCCESSION PLANNING

Do you have an emergency succession plan for your executive officers? We certainly hope you do. Over the past couple weeks we have been involved in an unfortunate instance where one of our clients unexpectedly lost the services of their president. This specific individual was younger, and it was assumed that he would be with the bank for a very long time. Unfortunately that was not the case, and the bank was left without a president.

Luckily for this particular bank, their "bench strength" is very strong. We do not know what will be the solution for the permanent replacement, but in the interim they have a very capable management team that can keep the bank together. This is fortunate for them. If they did not have this level of bench strength, they could be in a real world of hurt.

Succession planning has become a real regulatory "hot topic" over the past couple years. This is for good reason. When you are thinking about succession planning, think about it from a management, director, and shareholder perspective. Also think about it in terms of "long term" succession plan and "emergency" succession planning. Hopefully you will not need your emergency succession plan, but it is much better to have one and not need it than need it and not have it.

MULTIPLE VALUATIONS

The first quarter of each year is what we affectionately refer to around our firms as "valuation season." We provide annual stock valuations for a number of clients. We recently had a client ask whether the bank holding company should get multiple valuations - one for the ESOP and one for all of the other shareholders. Our advice is no, the holding company should not get multiple valuations. Instead, we think it a better practice to get one valuation. This avoids the potential problems associated with having two valuations of the same stock, both of which have a different value. We think it better just to have one valuation done for the entity, which is typically the ESOP valuation.

One thing to keep in mind is that we have seen a couple valuation experts that do not like their ESOP valuation to be used for anything other than the ESOP. If you are getting an ESOP valuation and are using it for another purpose, please take a look at your engagement letter with a valuation expert. It may be that you need to ask your valuation expert to revise the engagement letter if it says that the valuation can be used for no purpose other than the ESOP.

MERGERS AND ACQUISITIONS

As most *Musings* readers know, our firm provides turnkey services on mergers and acquisitions. We provide both the financial advisory piece and the legal piece. We have had active merger and acquisition years in both 2018 and thus far in 2019. Mergers and acquisitions are technical from both a financial and legal standpoint. They are also fraught with pitfalls and potholes.

To assist our client base around the nation with regard to understanding mergers and acquisitions, we are providing a Merger and Acquisition Workshop sponsored by ICBA. This is a workshop designed for any community bank director, CEO, CFO, or senior officer. It will provide enough big picture directional instruction for the directors and CEOs, and enough number crunching and review of financial models for the CFOs. The next workshop will be held in St. Louis on June 18th and 19th. You can get additional information through the following link:

ICBA Community Bank Mergers & Acquisitions

CONCLUSION

It was great to see many of you at the recent ICBA Convention in Nashville. We look forward to seeing the rest of you at your banks over the summer and fall coming months.

See you in two weeks.

Jeff Gerrish *Philip Smith* *Greyson Tuck*

