



*The*

# *Chairman's Forum*

*Opening the door to new ideas*

*Newsletter*

*Gerrish Smith Tuck, Consultants and Attorneys*

*May 2019*

In this month's edition of *The Chairman's Forum Newsletter*, we look at a number of interesting situations. In particular, we ask if you really know who your stockholders are, we ask if you know what vote is required to elect your directors and we challenge Chairmen to consider best practices in other industries for new ideas in banking.

We also critique a recent headline regarding the role of community banks and mergers of equals. We attempt to point out how a headline, in and of itself, might be misleading in terms of a potential strategy for a community bank. You may need to keep in mind that, when considering something like a merger of equals, all community banks may not be alike.

We hope you find this month's edition interesting and entertaining. Please let us know any time we can help.

Happy Reading!

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## *Chairman's Summary*

- ◆ Local ownership is important.
- ◆ Look for best practices in other industries.
- ◆ Do not take director voting for granted.
- ◆ Real community banks have unique concerns.

## *Who Are These People?*

Who are these people? That was the question we recently heard the President of a community bank ask. Was he watching the front door of the bank and not knowing the people who came in? Was he wanting to know who a potential new loan customer was that he had never met? Was he perhaps disgruntled at dealing with examiners in his bank? The answers to all of those questions is “no”. Rather, the President asked the question when, quite surprisingly, he was reviewing his stockholder list! Even a relatively small community bank may wake up one morning and find that its total number of actual stockholders has grown to several or multiple hundreds of people. Moreover, when you scrutinize that stockholder list, you may be asking the question posed above as to who these people are. You may also be asking questions such as “If I’m the President of a community bank in Illinois, why do I have stockholders who live in California, Texas or Connecticut?”

This situation points out the benefits and sometimes the detriments of community bank stock ownership. The benefit is that many long-term families in an organization have a tendency not to want to liquidate their shares, but continue to pass them down through generations. The detriment though is that we often wind up with a much more geographically dispersed stockholder base than we expect or, candidly, than we need. Using the example above, if I am running a small bank in the Midwest, does my California stockholder really care about the funds that were allocated by the bank to put the bank's logo on the new scoreboard at the Little League field across town? Or is that stockholder more concerned about whether we are going to continue to pay a dividend?

In today's merger and acquisition environment, we are beginning to see these geographically dispersed stockholder bases create problems as community banks attempt to maintain their independence. The concern is that these stockholders are mere passive holders of the stock focused only on economic return. That can be a big threat to independence and the result is that the Chairman and the board need to find ways to address that concern. Often, the way that challenge is met is by the Board of Directors initiating formal stock repurchase transactions in order to offer liquidity to out of territory stockholders. In fact, in most cases, the organization can even specifically target only out of territory stockholders. The benefit is to "clean up" the stockholder base, consolidate the ownership into more local individuals and thereby promote the long-term independence and profitability of the organization. There are even ways to potentially structure transactions that would forcibly eliminate some of those

stockholders in ways that promote economic benefits to the stockholders who remain. So, as Chairman, keep asking yourself if you really know who these people are and if they are not individuals you know, or they live out of territory, consider taking steps to bring your stockholder base back to being more local.

### *Cars Versus Banks*

In last month's edition of *The Chairman's Forum Newsletter*, we compared the state of traditional banking to traditional car dealerships and pointed out how banks could take a cue from the auto industry to continue traditional methods of offering products and services, but also to find ways of taking the bank to its customers much the way car dealerships do through on-line services. We received a number of comments on that analogy.

One of our clients, who is a reader of *The Chairman's Forum Newsletter*, related her own personal experience in this regard and took the thought a step further. She recounted a recent car buying experience. She started by notifying the company of the kind of car and features she wanted. She was then notified by email when that type of car was available. She then went on-line and ordered the car (that took almost five minutes!). The company sent wiring instructions, she paid for the vehicle, she signed the purchase agreement and emailed it back to them. Four days later, the car was personally delivered to her even though the closest dealership was 500 miles away and the car arrived in perfect condition at 9:30 in the evening.

She indicated that in lieu of a long process at an actual dealership, this was easy, quick, painless and the automated systems worked great. In fact, she only talked to one person during the entire process. In her words, they turned buying a car “upside down”. She also then suggested that it would be great if we could figure out a way to do the same with banking! Amen to that.

While we might not desire to totally take the human element out of banking, and in a community bank that would be nearly impossible, we certainly shouldn't be blind to moving forward with better and more efficient ways of doing things. As Chairmen, lead your organizations in creative ways of thinking and see what develops. That may require you to look to other industries for some of their best practices.

### *Election of Directors*

How many votes does it take to elect a director? A typical lawyerly answer might be “it depends” or you may think there is some formula that could be applied. What if we told you that the right answer might be that it only takes one vote to elect a director?

Nonsense, you say. Your organization has several hundred thousand shares outstanding held by multiple stockholders and, therefore, it takes some kind of larger number of votes, perhaps a majority or two-thirds of all outstanding shares or something similar. At least that's what you think, but you might want to go back and check your Articles and Bylaws closely or even state law. If the statutory requirements or your Articles and Bylaws

provide that directors can be elected by a mere “plurality” of votes cast, then that means in order for a director to be elected he or she must simply receive more votes in favor of their nomination than votes against their nomination. In that unusual circumstance, one vote could elect a director.

Consider this simple example. Assume the organization has plurality voting. Assume there are six individuals who are up for election. For purposes of the example and to make the point, assume that of the 10,000 outstanding shares, 9,999 shares are voted for each of five of the directors, but the sixth director received no votes from anyone else. That director, himself, only owns one share. Assuming no one else receives any other votes, that director could elect himself to the board by voting his one share for himself because plurality voting indicates that the six individuals receiving the most votes with more shares voted for than against will be elected. You can see how this might play out in other circumstances as well. That is why we recently saw a large regional organization make headlines by submitting a proposal to their stockholders to adopt majority voting standards for directors rather than mere plurality voting. There are pros and cons to each system, but you might think about revisiting your corporate documents regarding how many votes it takes to elect directors so that you do not run into some odd circumstances in the future.

### **Community Banks and MOEs**

Let’s tackle two issues in this section based on an article we recently saw. The article was touting that mergers of equals (or MOEs) were “top of mind” for community bankers. The headline did its job because it peaked

our interest enough to read the article since we rarely find that community banks are interested in mergers of equals. Often, whenever a community bank is approached about an MOE, the community bank finds out they are the non-equal partner and their merger is really nothing more than a sale of their bank.

The article mentioned that community banks are increasingly discussing these types of transactions because of the positive stock market reaction to the BB&T and Sun Trust deal. That became our immediate “ah ha” moment. Why would a true community bank be focused on the public stock market reaction to a large super-regional merger creating the fourth largest bank in America? The answer is most true community banks would not be interested in that. The article went on to indicate that during a conference with a panel of public equity investors, one of the investors called on bankers to pursue more zero premium, merger of equal deals. Once again, as you read that language, it should help you understand the distinction here. These “community banks” that are concerned about these mergers of equals aren’t what you would probably think of as traditional community banks. A true community bank is not concerned about a panel discussion of public equity investors because the community bank is trying to avoid public equity investors like the plague. These banks are typically much larger multiple billion dollar organizations with publicly traded securities that, while they may call themselves community banks, don’t have true community ownership. Another comment in the article even quoted one CEO as stating that they raised the issues of an MOE in their strategic planning session because it was the “in vogue” thing all investment bankers

were talking about. Our guess is that most true community banks are less concerned about what is in vogue for the investment banking crowd and what is more likely to happen with their local stockholder base.

Again, as we often say, there is nothing wrong with being a publicly reporting bank or a larger organization, many of our clients are. In fact, maybe that is something we all strive for. But it points out the need to continue to read these types of articles critically and not simply rely on the headline as your guiding principle to suggest, in this case, that if community banks are looking at mergers of equals, maybe you should, too. It is arguable these are not the same types of institutions that you would think of as community banks and, as a result, their approach toward a merger of equals would be totally different from yours.

### **Meeting Adjourned**

This will be your last formal reminder in our newsletter of the upcoming Community Bank Mergers and Acquisitions Workshop. If you want to simply learn more about the process as a buyer or seller or learn how that process is impacting banks like yours that are trying to remain independent, we would encourage you to sign up and attend. You can click on one of the following links to learn more information.

To watch a promotional video about the workshop, [Click Here.](#)

For registration or other information, [Click Here.](#)



As we roll into the Summer, we are also getting a number of requests to lock down dates for strategic planning throughout the remainder of the year. Therefore, if you have some interest in doing that, please contact us at your earliest convenience as dates are filling up quickly. We look forward to seeing and hearing from many of you in the coming weeks and months.

Until next time,



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