

The



Opening the door to new ideas

Chairman's Forum

Newsletter

Gerrish Smith Tuck, Consultants and Attorneys

August 2019

For those of us who are football fans, it is either the kick-off to the season or what some of us view as the kick-off to the last part of the year. From now through January, we will have some form of high school, college or professional football every week! It also starts the fall strategic planning season and we will be on the road quite extensively in the coming months working with many of you to outline your strategic plans for 2020 and beyond. We are always appreciative of those opportunities to see many of you on a face to face basis and to hear the positive things your organization has done the past year. In fact, as you can guess, many of our stories, questions and anecdotes that we relay in our newsletters come from those meetings.

This month's edition of the newsletter explores a number of questions from directors including questions about M&A, advisory boards, the lending process and dealing with your regulators. We hope you find something of value and, if we can answer your questions, we hope that you will reach out to us.

Happy Reading!

Jeffrey C. Gerrish

Philip K. Smith

Greyson E. Tuck

*Gerrish Smith Tuck
700 Colonial Road, Suite 200
Memphis, TN 38117
Phone (901) 767-0900
www.gerrish.com*

Copyright © 2019 – Philip K Smith

Any accounting, business or tax advice contained in this communication, including attachments and enclosures, is not intended as a thorough, in-depth analysis of specific issues, nor a substitute for a formal opinion, nor is it sufficient to avoid tax-related penalties. If desired, Gerrish Smith Tuck would be pleased to perform the requisite research and provide you with a detailed written analysis. Such an engagement may be the subject of a separate engagement letter that would define the scope and limits of the desired consultation services.



The

Chairman's Forum

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys

August 2019

Newsletter

Chairman's Summary

- ◆ How to pick the perfect bank target.
- ◆ Are advisory boards helpful or hurtful?
- ◆ Should I remove my directors from the lending process?
- ◆ Should I call my state regulator?

Finding the Perfect M&A Deal

If your bank is looking for growth and you are primarily seeking that through an acquisition, as many banks currently are, how do you find the right candidate? Recently, we were contacted by the Chairman of the Board of an organization who thought that his bank wanted to begin the process of looking for another bank to buy, but, while the organization had a lot of good ideas about how they wanted the process to unfold, they couldn't quite get their arms around step one. As the Chairman put it, we know what we want to do, we just don't know how to get started.

If we wanted to give you the first true step, we would suggest backing up to the point of strategic planning and incorporating an entire discussion about M&A in your plan, talking about the pros and cons of doing a deal, considering various possibilities, etc. But let's assume you have already done that and now you are trying to take the first true tangible step. What

we often suggest is creating a template of the perfect or ideal acquisition candidate. By that, we don't mean selecting a bank by name, but rather outlining the characteristics of what a perfect target organization would look like. For example, what would the perfect candidate look like in terms of asset size, ownership, location and geography, loan portfolio mix, loan to deposit structure, organizational efficiency, net interest margin, sources of noninterest income, board composition, product and service offerings, future earnings potential, branch structure and market share, etc. Once you have outlined all of those key target desires as well as probably many others you can think of, then you have created the template for a "perfect" match. Then, you can take the template you have created and compare it to what's available or likely organizations in the market to see who may actually come the closest to fitting that.

That process might not identify every candidate you want to consider, but often what it may do is eliminate organizations that you might have otherwise thought would be a good candidate on some soft reason like "they are in a good market", but who otherwise do not meet your requirements. In essence, it helps you identify non-qualifying candidates that, if you were to pursue a deal, would otherwise be the proverbial effort to try to put a square peg in a round hole. So, start with identifying your true needs and desires and try to find as close of a match to that as possible rather than relying on "soft" decision points like "I have always liked their bank".

A related question we often get from Chairmen is in trying to determine what banks are available for acquisition if you are looking to buy and occasionally what organizations could be interested in my bank if I am looking to sell. If you ever have those types of questions or similar

questions, please feel free to pick up the phone and give us a call or shoot us an email. We constantly have various groups and entities from around the country that have contacted us either looking for banks to buy or looking for us to find an entity that might have some interest in them. If we can help manage that process for you, do not hesitate to reach out to us.

Advisory Boards - Revisited

A client recently asked us if we were opposed to the idea of having advisory boards. In true lawyer/consultant fashion, our answer was “it depends”. The way many organizations handle and manage an advisory board structure, in our opinion, is really detrimental to the organization as a whole and in those situations we certainly do not favor an advisory board. On the other hand, we have seen situations where the advisory board can work very well. There is no one size fits all, but there are a few best practices we think should be required if you are going to make your advisory board a success.

First of all, the advisory board needs to actually do something. If it is merely a throw-away title you have given to former directors of a bank you have acquired or to people in a new community where you have opened up a new office, but those individuals do not really have real power, then the advisory board often flounders. Likewise, if very little attention is paid to the advisory board, if they are not occasionally invited to full board meetings, if they are not included in the strategic planning process, if they are not paid a fee, then the position merely becomes “honorary” and it rarely has any success. In those circumstances, you would be better off without it. However, if you are willing to take the time to really use your advisory

board to, for example, provide input on strategic opportunities where those individuals have real knowledge (such as in a community where a majority of the Board has no experience) or if the advisory board even can provide input on loans or other critical areas, then you may find an advisory board a very important tool. Our experience has been that the key to a successful advisory board is that it must be something beyond an honorary position. Those men and women need to feel their time is valuable to the overall organization or else you are better off merely focusing on your core board.

Three other best practices for advisory boards might also be relevant. First, consider establishing specific term limits. This may ultimately wind up being your advisory board terminating at some point in the future, but that is better than letting it merely “wither on the vine”. While we do not typically recommend term limits for your regular board, it often works best at an advisory board level. Secondly, decide if you want to utilize your advisory board as a training ground or “farm system” for your full Board of Directors. It often can be a great opportunity to test the knowledge and skill of someone, their ability to interact with others and similar factors. Finally, as referenced earlier, someone needs to be keeping tabs on the advisory board. That likely means appointing an executive officer or one of your other directors to actually be in charge of calling meetings, ensuring they have some real work to do and similar factors. Do not let the advisory board attempt to manage itself.

Director Loan Committees - Revisited

An issue that continues to crop up every year or so revolves around the appropriate use of director loan committees and, in fact, the contention

by some that directors should not be involved in lending decisions or loan approval at all. A Chairman of the Board recently confronted us with that type of similar question for her organization. We have some specific thoughts, as you might imagine.

Recognize that the whole idea of directors being removed entirely from the lending process is centered around the idea that doing so will limit the liability of directors if loans go bad, the bank gets in trouble, etc. In our opinion, that view is based on the fact that during the last crisis when banks found themselves in trouble or when the bank failed, the regulators would often sue the directors (primarily to tap the pool of funds available through the directors' and officers' insurance policy) and a claim was made that the directors acted negligently in approving certain loans. Therefore, the thought goes that if the directors are not involved in reviewing and approving loans they can't be said to have acted negligently and, therefore, there is reduced liability for the directors. In essence, the directors washed their hands of anything to do with the lending process other than general oversight and left it to the true bankers, the management team, to make all lending decisions. It is sort of a "don't blame me, blame them" strategy.

We disagree with that approach. Loans are generally the largest asset category in the bank and accordingly the directors need to have some involvement. Furthermore, we believe the analysis above is flawed. Consider if a Board of Directors has absolutely no involvement in the lending process, but loans still go bad, the bank gets in trouble, etc. If the regulators seek to recover losses to the deposit insurance fund and are looking for someone to sue, we doubt that they would forego trying to make a claim under the D&O policy merely because directors were not involved in

lending. Rather, we think that type of process would be turned on its head and the argument would be that the directors are, in fact, still negligent in their actions because of their failure to be more involved in the lending process, failure to provide appropriate oversight, failure to know what was really going on in lending and that failure is evidenced by their refusal to have a director loan committee or otherwise be involved in lending. You can see how the argument could cut both ways.

Therefore, directors need to have involvement in the lending process, at least on some level. As institutions get larger, some choose to have directors involved on loans above a certain size threshold, loans that are deemed to be systemically important or other factors. We think some of those types of limitations might be appropriate, but on the whole please recognize that removing directors entirely from the lending function, in our opinion, does little to reduce director liability.

Can Your Regulator Be Helpful?

For those of you that are state-chartered banks, you have the interesting dilemma of having your state banking department as a regulator (after all they granted your charter) and either the Federal Reserve or the FDIC as your federal regulator. Occasionally, these different regulators may not necessarily view your bank in the same way. In those circumstances, we encourage you to look to your state regulator for help. The state is the primary chartering authority for your organization and absent some extremely severe problems, they are the only agency that has the right to withdraw your charter. It does not necessarily mean that a state agency will rush to your defense against a federal regulator, but the state agency, as the

chartering agency, certainly has more of your best interests at heart. Those state agencies typically know your bank better, have a better feel for local economies, understand the dynamics of various personalities and interests within your organization and a myriad of other benefits that the federal regulators do not have. Therefore, we have seen situations when there is perhaps some strain between a bank and its federal regulator that the state agency can be helpful in either trying to bridge the gap, help the bank better see the federal regulator's position or, in some circumstances, even siding with the bank against a position a federal regulator may be taking.

From a commercial banking standpoint, we will never see a circumstance where our regulators, either federal or state, take on the role that the primary regulator for credit unions on a national level seems to take on by being an enabler of everything the credit unions want to do rather than a restrictor of activities, but we certainly should view our regulators as an additional potential source of help in certain circumstances. Back during the financial crisis, candidly, far too many of the state bank supervisory authorities ceded too much power to the federal authorities for oversight and review of their state-chartered banks. We are pleased to see more and more state bank regulatory agencies beginning to step up and once again become the primary regulator for the banks in their state and organizations like the Conference of State Bank Supervisors are doing a great job of improving the structure and manner of supervisory conditions for their banks. Therefore, we encourage you to look to your state regulators, when necessary, as a source of potential assistance and not merely as an adversary.

Meeting Adjourned

If you have not already done so, we would encourage you and your directors to sign up for the annual Chairman's Forum that we host and which is sponsored by the Barret School of Banking and the ICBA. The upcoming event will be held January 16 and 17 at the Ritz-Carlton in Naples, Florida.

A link for registration is below and spots are already about 50% full, so we would encourage you to go ahead and sign up soon so that you can access the block of rooms and secure your spot. If you need further information about the forum, please do not hesitate to contact us.

<https://barret.ws/programs/community-banking-chairmans-forum/>

Until next time,



Jeffrey C. Gerrish



Philip K. Smith



Greyson E. Tuck

*Gerrish Smith Tuck
700 Colonial Road, Suite 200
Memphis, TN 38117
Phone (901) 767-0900
www.gerrish.com*

HOW TO CONTACT US:

If you have questions or comments about the newsletter or would like to ask a follow-up question, please email Philip Smith at psmith@gerrish.com.