THE
Board Chair Forum
NEWSLETTER

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys
November 2020

Well, most of us survived Thanksgiving where family gatherings were different, the banking environment continues to be different, and even football games are different. Additionally, we are now rushing headlong into Christmas and the New Year. As the pace of our daily lives quicken here toward the end of the year, this month's edition of the Board Chair Forum Newsletter looks at a few practical examples of things impacting the daily lives of the Board Chair and your organizations as a whole, takes a unique look at the current M&A market, and some practical advice on managing through an unexpected cybersecurity problem. In addition, we will consider a capital raising alternatives, the continuing role of efficiency, and a few things for which to be thankful.

We hope this month's Board Chair Forum Newsletter provides valuable insight to you, and we also hope everyone voted early and often! Now, if we could just get finished counting! Anyone remember "hanging chads"? Hang in there.

Happy Reading!

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Board Chair's Summary

- M&A Confidentiality versus Transparency
- Chick-fil-A, Banking and Efficiency
- Alternative Capital Planning, Looking Inward
- Leadership During a Data Breach: Don't Panic
- Continuing to be Thankful

M&A Confidentiality versus Transparency

Our firm continues to be involved in a number of different M&A opportunities in different parts of the country, and ranging from small organizations that are selling, to large non-bank organizations looking to buy. Between those extremes, we are involved in numerous other transactions of more typical structures and sizes. In all of those, an underlying theme that is always present but which has recently emerged in some unique ways, is the role of confidentiality versus transparency. In almost all buy and sell scenarios, you would think that the utmost focus is on confidentiality and, for the most part, that continues to be true. The parties often sign confidentiality or nondisclosure agreements to share information, and try everything possible to keep anyone outside of a select few from knowing that the organization is either looking to buy or sell. Ironically, perhaps, we often find that absolute confidentiality is nearly impossible to maintain. Invariably, we will hear stories from the Board Chair that someone at church told him that they heard someone mentioning at the Rotary Club meeting that they had a friend who knew someone who worked at the bank, who said their cousin told them that the bank was for sale. So, turning the whole idea of confidentiality on its head, we had one small bank seller who indicated they wanted to be fully transparent with their board, their employees, and their community, and rather than keeping everything confidential, actually went and told everyone that they were contemplating a sale. Guess what? No one was shocked. In fact, the employees appreciated the openness and candidness of being "in the loop," and the board and management committed that they were doing everything possible to find the best possible suitor who would protect the community, the employees, and the like. An unusual strategy, but one that worked for that small bank seller.

Consider also, the role of confidentiality versus transparency in the sharing of information. We have occasionally encountered situations where buyers or sellers did not, for one reason or the other, want to share certain data or information with the other side. While there are certain prohibitions on what can be shared (for example, examination reports), most information can be protected under an agreement between the parties. Trying to withhold certain information on the front end only leads to further problems on the back end. So, between the parties negotiating a transaction, the utmost transparency is what will lead to the greatest result. For example, if you are potential seller and you have some loans that you think could be problematic, you may have to provide an extra reserve allocation against, or something similar, do not hesitate to share that with a potential buyer. You would rather have the buyer factor that into the price they are willing to pay on the front end, rather than having them try to lower the price at some point in the future when the loans really do go bad.

A final word about the role of confidentiality versus transparency occurs when we are either representing a bank that is marketing itself for sale, or when we are representing an organization looking to buy a financial institution. When representing the seller, of course certain confidentiality often needs to be maintained. For example, we do not just call a dozen other organizations that might be interested and let them know that our client is for sale. Rather, it might begin with a general description to ask a potential buyer if they would have interest in a commercial bank located in a particular state with a certain kind of loan portfolio mix and of a certain asset size. That is done on the front end without really revealing who the target organization could be. On the other end, when we are representing buyers, we find it does very little to try to hide who the true buyer is. Obviously, the seller will eventually find out who the buyer is going to be, so there is no need for us to try to make a pitch to acquire an organization with "an undisclosed buyer with plenty of capital." Buyers should be proud of who they are and what they bring to the table, and therefore more transparency is probably beneficial in promoting a good transaction between the parties.

Chick-fil-A, Banking and Efficiency

In recent editions of the Board Chair Forum Newsletter we have talked about the number of branch closures that are happening among larger organizations. In fact, consider some of these comments and quotes about banks that have recently announced they are shuttering branches:

"[The bank] is reducing its physical footprint by 15% by consolidating branches, as more of its customers use online and mobile banking channels."

"The company will close branches and cut jobs with plans to reinvest some of the savings into digital enhancements."

"The company unveiled a sweeping cost cutting plan that includes more remote work opportunities and branch closures."

"[We will focus on] the trend in customer preference by serving customers when and how they choose, while also driving efficiencies and operations."

"We are striving to create a common and consistent customer experience, whether the interaction is in person, through digital channels or telephonically."

So, the trend toward improved efficiency and perhaps fewer or different types of branches continues. As Board Chairs, should we focus on doing more with less? Consider what some fast food operations are doing. Chick-fil-A is a prime example. The entity originally started off only being available in malls (for those of us old enough to remember that). Next, they expanded into free-standing facilities with lobbies. Now, lobbies are not open, but yet they have been able to actually improve the ordering and efficiency process through the use of ordering on a mobile app, increased employees assisting with the drive-thru, employees with iPads standing in the drive-thru lanes facilitating orders, and the like. Is anyone really disappointed that they are not able to go inside the location? We think it is important for financial institutions and, in particular community banks, to continue to look for queues from other business sectors on how to continue to drive efficiency in banking, which has historically not been very efficient. So, consider how your organization should react with less lobby traffic or current closed facilities. Consider whether a reduction of overhead expense could be used to better invest in technology.

Alternative Capital Planning, Looking Inward

We have participated in a lot of discussions recently about the need for organizations to raise capital, either for specific strategies or to simply beef up their capital for anticipated downturns in the future. If you talk to your friendly correspondent banker, they will simply want you to take out a line of credit secured by the bank stock for these purposes. That can be very effective and efficient. If you talk to your investment banker, they will likely be pushing subordinated debentures for the potential capital treatment it creates, the benefit of not pledging bank stock, and other factors, yet you have to take the full bucket of funds at one time. Either of those potentially could be expensive. So, make sure you are shopping for the best rate. But, consider an alternative.

Many of our clients lament that there are stockholders, directors or other individuals that would like to own more stock, but there simply "isn't any stock available." Almost always that is not true. There is plenty of stock available, it is just that the bank or holding company chooses not to sell more shares. So, consider looking inward if you need more capital, rather than taking on some type of debt obligation. If you have an existing stockholder base that would love to have the opportunity to own more stock, then doing a stock offering to existing stockholders, (we often refer to that as a "rights offering"), might help accomplish a lot of things you want. You certainly get more actual capital in the organization without taking on debt (your regulators will like that), stockholders who want to increase their ownership have the opportunity to do so, stockholders that want to avoid dilution will have the opportunity to protect their position by subscribing for a pro rata share of any new offering to existing stockholders, and you will not be adding new third party stockholders or investors with whom you are not familiar. Far too often we see organizations immediately look outside the organization for sources of capital, when the best source of capital may be sitting around the board table or in your stockholder list. One caveat with a rights offering, however, is the potential for additional costs and expense. Whenever you are issuing corporate securities, the issuance must be registered or meet a specific securities exemption. This is not a task you want to undertake without professional guidance and assistance in order to avoid a securities law error and running up even more costs. Therefore, an alternative of a private placement to a few stockholders might be better. Make sure you get professional assistance.

Leadership During a Data Breach: Don't Panic

At almost every strategic planning session we conduct, we spend a small amount of time reviewing the results of questionnaire responses about Strengths, Weaknesses, Opportunities and Threats to the financial institution. In almost every case, one of the leading Threats identified is cybersecurity. While most organizations are mindful to mention cybersecurity, it is a different question as to whether they have a true disaster recovery policy that they will follow, or a crisis management policy, or something similar when a real threat arises. If you do not have that type of formal documentation, it is probably time to develop it.

We have recently been working with a client that was exposed to a cybersecurity event, not within the bank itself, but through a vendor who had some of the bank's data and that data became compromised. The situation points out the need for leadership of the Board Chair, the Board of Directors and at the CEO level. The first and number one strategy to employee is not to panic. When is the last time you heard of a bank failing or losing thousands of customers over a data breach? There are mechanisms in place to protect the organization, and most of those work pretty well. This organization, through its leadership, took the appropriate steps of not panicking, pulling together a team to figure out the extent of the issue and manage through it. Some of the first steps were to contact our firm as outside counsel, contact the bank's insurance provider, and also contact their state and federal regulators. Likewise, the bank confronted the issue head-on and began to deal with the third party vendor to demand transparency, ask for questions to be answered regarding how the vendor was rectifying the problem, asking tough questions about the causes and purposes behind the data breach, and ultimately focusing primarily on protecting customer information and managing the customer communication process.

We have found that most customers, including especially customers of community banks, will simply shrug their shoulders at a data breach or something that seems technical in nature, provided the bank manages the message and controls the information flow to them in a way that is open, honest, transparent, but also reassuring. Your customers have always believed that you will protect them, their information and their finances. This is the perfect opportunity to demonstrate that they are correct by not panicking, and leading with steady confidence.

Continuing to be Thankful

As we have passed through the Thanksgiving season, we are reminded of a few things in the financial institution world of which we should be thankful. The first is that the outlook for community banks and the financial institutions sector in general continues to be positive. Our firm recently had the opportunity to be the guest presenters on a video conference that talked about the future of banking and the outlook for all of us. This was a free webinar, and a link to the video presentation by members of our firm can be found here. This was done in conjunction with the Barret School of Banking. We hope you find this information helpful.

A second item for which to be thankful is that you will still have the opportunity after the first of the year for a safe and socially distanced in-person live Board Chair Forum in Naples, Florida. For more information on how to register yourself or your directors for one of the few remaining slots, you may utilize the following link: Community Banking Chairman's Forum.

We are also thankful that community banks continue to engage in strategic planning, either virtually or in person. As we have moved through the fall and looked into the first quarter of 2021, many of you are continuing to request in-person or virtual strategic planning sessions as a way of continuing to drive shareholder value. We are thankful for your business.

And there is reason to continue to be optimistic and thankful for the coming new year with the hope that there is no way it can be more difficult and odd than 2020 (fingers crossed).

Meeting Adjourned

The next 30 days or so will be hectic, so hang in there and let us know how we can help. We will publish one more Board Chair Forum Newsletter prior to the end of the year, and you can continue to review our periodic videos at:

https://www.youtube.com/channel/UC8NUEl2_RDd9Qzc-ZUjUD1g/featured.

Until next time,

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