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# GERRISH'S MUSINGS

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March 31, 2021, Volume 437

Dear Subscriber:

Greetings from Louisiana, Georgia, South Carolina, Ohio, West Virginia, Nebraska, and Oregon!

## DISSIDENT SHAREHOLDERS

Tis the proxy season, when dissident shareholders seem to most often raise their most outlandish positions. We are not sure if it is just proxy season, if it's the pandemic lockdown, or what has given rise to the flurry of dissidents in community bank holding companies lately.

Most dissident shareholders begin their quest to reach their goals through a request for corporate books and records. For Delaware chartered bank holding companies, the requirements are set forth in Section 220 of the Delaware General Corporate Law. Since Delaware has for years been the "gold standard" for corporate law, many state laws follow the Delaware language. Without getting into the nauseating details, the Delaware statute generally requires a stockholder to have a "proper purpose" for requesting corporate records. The Delaware Supreme Court recently weighed in on what is required for a proper purpose. The answer by the Supreme Court was, "not much."

The Court basically indicated that as long as the shareholder indicates "some purpose" such as that the shareholder wants to "investigate" corporate wrongdoing, then that is deemed to be a proper purpose. According to the Supreme Court of Delaware, it does not matter whether or not the shareholder's investigation can bring any "fruit" and whether or not the available claims are actually actionable against the corporation or its directors. The general rule from this particular Delaware Supreme Court case regarding access to corporate books and records is that their interpretation is about "as broad as it is long." Keep that in mind next time your bank holding company has a dissident shareholder.

## DISSIDENTS #2

As noted above in *Musings*, dissident shareholders seem to be coming out of the woodwork of late. Generally, a dissident has some purpose for their actions. We suppose some of them could simply be altruistic and want to benefit the corporation from their sage advice, but for the most part, the dissident shareholder wants something tangible such as a seat on the board, to have his or her stock repurchased, to have the company sold, or something else. When dealing with a dissident, our general advice is to hold them off and begin discussions with them to determine, as best as possible, their actual motives and what their end game is (i.e., what is it they want to see happen as a result of their agitation). If it is repurchase of their shares, then as we have often put in *Musings*, that is a great allocation of community bank capital. If it is a seat on the board, the receptivity to that issue may depend on whether it is a seat on the bank board, a seat on the holding company board, or a seat on both boards, and whether the existing boards could tolerate the dissident or dissident's representative.

In any event, when dealing with a dissident, the important thing is to find out what their goal is and to see if the dissident's goal can be met (or partially met), and the company's goal to remain independent and continue without interference from the dissident can be met as well. Although sometimes the dissident's goal and the company's goal are mutually exclusive, that is not always the case.

## THE EXAMINER FROM HELL

As we have discussed in recent *Musings*, we reasonably believe that the regulatory environment under the current administration will continue to undergo a change. In other words, we do not anticipate the friendly federal regulators will continue to be as friendly as they have been under the previous administration. Virtually all the members of our consulting and law firms have significant experience dealing with regulatory issues, troubled banks, negotiating MOUs, cease and desist orders and the like. For some of us it has been a lifelong adventure. As we were commiserating about the regulatory changes, we recalled the infamous Examiner from Hell who appeared during the Great Recession. We honestly hope this friendly federal regulator has retired by now, but are not sure. In a nutshell, the Examiner from Hell criticized a client for failure to comply with a consent cease and desist order.

When the order was proposed by the friendly federal regulator, we were requested by the client to assist. We pushed back on the order and its contents. We finally reached a resolution which modified the order significantly. The client was less unhappy than they would have been with the proposed order, and the regulators were unhappy they had to "give," so we assume it was a good settlement for all.

Once the consent cease and desist order was entered, the bank was reexamined. The bank was criticized for failing to comply with the consent order because, in part, the consent order required within 10 days after the entrance of the consent order the bank would do “X.” The bank, based on our advice to be proactive, did “X” 30 days before the entry of the order. In other words, the bank knew that “X” was going to be in the order so they got on it and completed “X” 30 days before the entry of the order. The examiner came in and because they had not completed “X” within 10 days after the entry of the order, the bank was cited as being in violation of that provision of the order. We will always remember with fondness in our hearts and minds the Examiner from Hell.

### STRATEGIC PLANNING RESULTS

As most *Musings* readers know, our firm facilitates dozens of community bank long-term/strategic planning events annually. We enjoy assisting community banks in helping set the strategic direction for their banks and holding companies moving forward. We also enjoy assisting the banks in determining how to remain independent if that is their long-term strategy. We do realize that some of these strategic planning events are simply “check the box” exercises for the bank due to an upcoming regulatory examination or criticism in a past examination, or something similar. We understand that. We also understand that a strategic planning session may not result in any massive changes in strategy. In fact, it probably shouldn’t.

A strategic planning session is directional and changes in direction, at least for a community bank, and unless there are significant problems should generally be incremental over a period of time. If you participate in your board and management strategic planning session and at the end of the session you realize that no massive changes in strategy have been made, then that is probably ok. Sometimes even minor changes in the plan, such as moving into areas of lending the bank has not been involved in before, can result in significant changes to the bank’s profitability and risk profile. Consideration of strategic issues should be on the plate of every board on a regular basis. Whether that means your bank conducts some type of planning exercise annually is up to your Board and its culture. Our recommendation, however, is that the board at least quarterly give consideration to forward-looking strategic and risk issues as a matter of best practice.

### BANK LIQUIDITY

In our travels around the country visiting with community bankers and their boards, one issue that always seems to come up is the excess on balance sheet liquidity maintained by most community banks. This excess liquidity is generally attributed to the large amount of government stimulus that has

moved into the economy through PPP and the like. The question we get most often is what do you do with this unwanted liquidity? The obvious answer is – generate additional loans since that liquidity is costing virtually nothing. That, of course, is easier said than done since every bank is looking at something to do with their excess liquidity.

The \$1.9 trillion stimulus bill, the American Rescue Plan, that the President recently signed into law will unfortunately only exacerbate the problem.

We wish we had the “silver bullet” on this issue or that a *Musings* reader that does will share it with us.

### TARP 2.0

The Treasury recently announced the establishment of the Emergency Capital Investment Program, which provides for the investment of up to \$9 billion in Community Development Financial Institutions and Minority Depository Institutions. Of course, we took a look at the details of the program to understand how it might impact or be beneficial to our clients. In looking closely at the details, we really see this as TARP 2.0. (We assume *Musings* readers remember TARP from the Great Recession.)

The program allows the Treasury to make investments in Community Development Financial Institutions and Minority Depository Institutions. The investments will take the form of Preferred Stock, except where the institution cannot issue Preferred Stock, such as in the case of a Subchapter S corporation. In that instance, the investment will take the form of a Subordinated Debenture.

The terms of the investment are strikingly similar to the terms of TARP investments. The dividends are noncumulative, and the applicable dividend rate is dependent upon the increase in qualified lending compared to baseline measurements. While the stock is outstanding there are also certain limitations on executive compensation, share buybacks and dividend payments.

Overall, we see the Emergency Capital Investment Program as essentially TARP 2.0. That is not a bad thing. There were many community banks that took TARP during the Great Recession and it served them quite well. If your community bank is in need of capital and qualifies as a Community Development Financial Institution or Minority Depository Institution, this program might make sense for your organization. We have created a Memorandum to Clients & Friends that summarizes the program and relevant considerations. Please let us know if you would like a copy.

### RESTRICTED AND CONTROL SECURITIES

Many bank holding companies (and banks that are not in a holding company structure) serve as their own stock registrar and transfer agent. This is a fancy way of saying that the holding company

keeps control over its stockholder list, and has responsibility for assisting shareholders with the sale or other transfer of shares. Holding companies that act as their own registrar and transfer agent need to make sure they understand the rules applicable to the resale of Restricted and Control Securities.

Generally speaking, Restricted Securities are shares that were issued pursuant to a valid securities registration exemption. In other words, these are shares that were sold in an offering that was not registered with the SEC. Control Securities are securities owned by a control shareholder, such as a Director, executive officer or greater than 10% owner.

The SEC has applicable rules on the resale of Restricted and Control Securities. One question we often receive is whether these rules are applicable if the holding company is not an SEC reporting company. The answer is generally yes. With this in mind, companies that act as their own registrar and transfer agent need to be able to spot circumstances where the rules may be applicable, and to generally understand how it might impact the transfer.

Although an explanation of the rules related to the resale of Restricted or Control Securities is beyond the scope of this *Musings*, for today's purposes, we are simply reminding you that there are issues that may present themselves. If one of your shareholders attempts to sell or otherwise transfer ownership of Restricted Securities, or a control shareholder attempts to do the same, keep in mind the applicable requirements. Make sure a qualified individual reviews the proposed transfers to ensure compliance with the applicable securities rules.

## STOCK VALUATIONS

Over the past couple weeks we have been involved with several different valuations of bank holding company common stock. A number of these are valuations we have completed at the request of our clients. In one circumstance, we were asked to review another professional's valuation to provide any comments we may have.

Based on our work in this area recently, there are a couple items of note. First, we are seeing year-end valuations that are a little bit lower than might be anticipated and are resulting in a bit of surprise and angst among bank executives. This is primarily due to these valuations incorporating a December 31<sup>st</sup> valuation date. Keep in mind that the stock market as a whole, and particularly the bank stock market, was not the same at year-end as it is today. Bank stocks have enjoyed a nice runup over the past 90 or so days, and a valuation date of December 31<sup>st</sup> does not take this runup into account.

Second, one of the items that is particularly in focus for valuations this year is known as the Beta Coefficient. This is essentially a measurement of how the value of the stock moves in comparison to the market as a whole. A Beta Coefficient of 0 means that there is no correlation between the value of the

stock and the movement of the market as a whole. A Beta Coefficient of 1 indicates that there is a direct correlation between the movement of the market as a whole and the value of the individual stock. A Beta Coefficient of 2 indicates that the change in the value of the individual stock is exaggerated when compared to changes in the market as a whole.

Without getting too technical into the valuation theory here, what is interesting is that we are seeing a pretty wide range of Beta Coefficients in these recent valuations. We have seen some valuations with a Beta Coefficient of 1, indicating that the value of the stock is directly impacted by changes in the market as a whole. Other valuations utilize a Beta Coefficient closer to zero. The appropriate coefficient is up to the individual valuation expert, and is based on a number of different applicable facts and circumstances. The chosen Beta Coefficient typically impacts the valuation in a couple different areas. The exact Beta Coefficient used does not have significant sway on the overall valuation, but it is an important component, particularly when you have seen the volatility in stock prices over the last year or so.

Our overall impression is that many of the valuations today are coming in close to where they came in about a year ago. In the intervening time, there was a significant drop and a nice recovery.

### WHAT A YEAR!

In preparing this *Musings* we thought it would be interesting to go back and look at the *Musings* that we provided one year ago, on March 31, 2020. What a trip around the sun! Our *Musings* from one year ago had a “Greetings line” for the first time from “working remotely,” and contained an introduction of the SBA Paycheck Protection Program. Last year’s March 31<sup>st</sup> *Musings* recounted a noticeable slowdown in community bank M&A activity and briefly described a meeting we had with a client who was interested in considering how to take advantage of opportunities that will present themselves in the near term, which was noted to be “right in the middle or at the end of the pandemic.” (Our timing was a little bit off on that one!)

The past year has been nothing short of extraordinary. There are a number of things that could be said as we reach what we see as the one-year mark of the pandemic. We believe the most important item of note is the resiliency of community banking, both the banks themselves and the community bankers associated with them. Over the past year, community banks have done an extraordinary job of navigating a turbulent time and, most importantly, supporting the communities in which they serve. We have seen numerous examples of community banks going above and beyond to support their customers and employees.

We consider it one of our firm's highest honors to be involved in the community banking industry. We have said before, and will say again, that we believe community bankers are the salt of the earth. This past year has only reinforced this belief. We look forward to continuing the opportunity to partner with you as we move past the pandemic and into whatever the future may hold.

## CONCLUSION

We are at the end of the first quarter of 2021. We are optimistic we are also near the end (or at least it is in view) of the issues raised by the pandemic. Nevertheless, keep your guard up, keep yourselves and families safe, and continue what you do as community bankers.

See you in two weeks.

*Jeff Gerrish*

*Philip Smith*

*Greyson Tuck*

### Upcoming Webinars and Workshops:

- April 13, 2021 – ICBA Webinar – “A Guide to Community Bank Expense Practices” (Cliston V. “Doc” Bodine, III) Registration link: [A Guide to Community Bank Expense Practices](#)
- April 15, 2021 – ICBA Webinar – “Specific Strategies to Ensure Long-Term Independence” (Greyson E. Tuck) Registration link: [Specific Strategies to Ensure Long-Term Independence](#)
- May 4-5, 2021 – ICBA Mergers & Acquisitions Workshop. (Jeff Gerrish, Philip Smith and Greyson Tuck) Registration link: [ICBA Mergers & Acquisitions Workshop](#)