GERRISH'S MUSINGS

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April 28, 2017, Volume 343

Dear Subscriber:

Greetings from North Carolina, Florida, Wisconsin, Minnesota, South Dakota and Alabama!

IS THE CHAIRMAN TOO OLD?

I was recently working with a well-run community bank. Well-run but for the fact that its board had become, for a variety of reasons, very dysfunctional. The board members did not get along. They argued with the management team. They argued about compensation, committee appointments, and pretty much everything else.

After spending some time with this group, I realized that the problem was that the chairman was simply disengaged. This particular individual, who is not a large shareholder, had been chairman of this organization for a lengthy period of time. He had, frankly, out lived his usefulness in that role. Instead of being a strong chairman, or even having a strong vice chairman, this particular board had neither. As a result, every meeting involved the proverbial "food fight." My recommendation to this board was not rocket science. It was not well-received by the current chairman, but I recommended that the board either appoint a new chairman or a strong vice chairman to take control of the meetings and the board activities. This particular board really needed a disciplinarian who could also provide some leadership. I believe they are going to accept this advice and replace the chairman at the next meeting. It will be interesting to see if this dysfunctional board becomes functional or if they are simply too far gone.

"SMOKING OUT" SHAREHOLDER ISSUES

We are currently assisting a bank holding company that has what I would classify as a complex shareholder base. This particular holding company has a large percentage of its shares that are held in brokerage accounts, with some being objecting beneficial owners and others being non-objecting beneficial owners. We are assisting this holding company in considering a Subchapter S reorganization. During a recent meeting with a board and senior management, we discussed all of the advantages and disadvantages of a Subchapter S. During the discussion, it was also noted that one of the advantages that would result from the reorganization is the fact that each of the shareholders holding shares in brokerage accounts would have to take their shares out of the brokerage accounts in order to continue as a Subchapter S shareholder. This would cause each of the objecting beneficial owners to be known to the holding company. It was commented this would "smoke out" any shareholder issues that might be lurking, particularly in the objecting beneficial owners category. I completely agree with this line of thinking. If there is any type of problem in the shareholder base, it is best to know it sooner rather than later.

THE TRUMP TAX PLAN

As most of you know, earlier this week the Trump Administration set forth the broad outline of its tax plan proposal. This proposal involved a 15% corporate tax rate (and according to several reports, a 15% tax rate on pass-through income in a Sub S, LLC or certain other pass-through entities) and various grades of personal tax rates. The question we have been receiving often is whether Subchapter S still makes sense for those who are currently Sub S or contemplating it. The answer is clearly yes. Sub S still eliminates double taxation and benefits the company overall and puts more money in the pocket of the shareholders.

FAIR LENDING

As most of you know, during the Bush Administration there was not much activity as it related to fair lending issues. During the Obama Administration, quite the opposite. It is anticipated that during the Trump Administration, the regulators and Department of Justice will probably back off of fair lending issues somewhat. Having stated that, however, in the last month I have received emails from two clients who have undergone compliance exams and are being targeted with fair lending claims. I would like to say this is going to go away completely, but it appears that the regulators either have not gotten the message or they view the issues so

egregious that they need to be addressed presently. My guess is they have not gotten the message yet.

SHAREHOLDERS MEETING

Greyson and I had the opportunity to jointly attend a recent shareholders meeting. The purpose of the meeting was to approve a transaction with which we had assisted the bank. The meeting could best be described as a "love fest." It was full of reminiscing. The shareholders were very committed to the bank remaining independent and demonstrated that at the meeting. Of course, the fact that the bank is putting up good numbers and all is going well financially does not hurt. I wish all shareholders meetings were that easy. At least it was not Wells Fargo!

ACCOUNTABILITY

We all need accountability in our lives. So do our banks' officers and directors. In fact, I have recently written a blog for *Banking Exchange* that dealt with this very issue as it related to strategic planning. Why in the world would we bother to spend a day together to figure out what to do with the bank's life if there is no accountability for execution of the plan? It seems like it is kind of a waste of time to me. Fortunately, our clients, in general, are pretty good about reviewing and holding management and the board accountable for the matters discussed at the planning session. That is the good news. I have heard some horror stories about banks spending multi-days planning for the future and then spending "no days" executing on the plan or even looking at it until the next planning session arrives.

YOU DON'T GET WHAT YOU DON'T ASK FOR

We are currently assisting one of our clients in a branch acquisition. At this point in the process we are acting much more in our financial advisory/consulting capacity than our legal capacity, because we are still in the negotiation stage of the transaction. I was reminded this week of the old adage that you never get what you don't ask for.

The investment banker on the opposite side of this transaction is with a large and well-known investment banking firm. While talking through some of the negotiation points relative to the transaction, we had a certain request the other investment banker thought was "nickel and diming" the transaction. His comment to me was that our request was immaterial to the transaction. My response was that it was not immaterial to the transaction because it was

material to my client. I also reminded him that if it was immaterial to the transaction he should not care about giving up on it anyways.

In the end, we ended up negotiating something that was agreeable to everyone, and we saved our client an appreciable amount of money. If you are negotiating any type of acquisition transaction, either on the buy or sell side, do not be afraid to ask for what you want. If you don't, you will never get it.

FEDERAL RESERVE REQUIREMENTS

We have been working with one of our clients for a number of years in trying to resolve their Trust Preferred Securities. This particular client is very strong at the bank-level, with good earnings, capital, asset quality and the like. However, the organization has a pretty heavy debt load at the bank holding company, attributable to some pretty significant TruPS issuances. The bank got into some real trouble during the height of the crisis, but it has emerged nicely. The problem is that the Fed has been very proactive in its regulation of the bank holding company, since its debt-to-equity ratio is much higher than the Fed would like it to be.

Over the past couple of weeks, we have been able to take an important step that we have been working on over the past couple of years by agreeing with the TruPS holders to stand down and, more importantly, to essentially provide an option for the discounted payoff of the Trust Preferred Securities. Due to some tax accounting rules, one of the TruPS holders is very reluctant to formalize the option to purchase at a discounted price. They have given many verbal assurances that the TruPS could be bought at any time for a certain price, but they have not put it in writing. The difficulty is that the Federal Reserve has indicated they are going to require the discounted payoff to be put in writing before they will even consider approving the transaction.

The Federal Reserve's position has put us in a little bit of a predicament. On one side of the transaction we have a creditor that is reluctant to put a discounted payoff into writing. On the other side we have a regulator that will not consider approving the transaction until that happens. We are working through it. I will keep you updated.

TRANSACTION CLOSING ISSUES

On Monday we are officially closing on a transaction that we have been working on for some time. This is the sale of a $120 million bank to another community bank. One of the requirements in the contract is that our client terminate all of their employee benefit plans

immediately prior to closing. This is a fairly standard provision in these types of agreements, since the acquirer has their own benefit plans for the target bank employees.

The one unusual thing about this particular transaction is the fact that our client has a defined benefit pension plan. Those are not very common in the industry today. Most banks instead have a defined contribution plan. The termination of a defined benefit plan is not quite as easy as the termination of a defined contribution plan.

Our partner, John Seabold, has a wealth of knowledge on the workings of all of these type of plans, including their termination. The counsel for the acquirer has a tax and employee benefits partner that has the same. It has made this particular piece of the closing, which I have seen be a difficult piece many times previously, go well in the transaction. Assuming no last minute hiccups, this defined benefit plan will be terminated Monday morning, and the transaction should close without issue.

If you have a defined benefit plan, or are thinking about buying a bank with a defined benefit plan, keep this in mind. If you are terminating that plan as part of a transaction (or for any other reason) be sure you are on the specifics early. It is detailed and has a lot of areas to trip up. Make sure you have good assistance that understands what they are doing.

STOCK REPURCHASE PLANNING

For many of you, an important strategic decision is how to appropriately allocate capital to enhance the value for your shareholders. Often this involves consideration of redeeming holding company stock. The obvious benefits to redeeming stock are that the shareholder selling his or her shares receives cash, pays his taxes, and moves on. The shareholders remaining with the bank holding company who do not sell their shares have an increase in ownership percentage, increase in earnings per share, increase in return on equity, the illusion of share liquidity, and if the dividend is calculated as a percentage of earnings, then they may also get an uptick in their dividend.

I recently received a call from a long-time client who had never done a stock repurchase plan. His holding company owns stock in another bank holding company. That bank holding company had sent out a one-page letter offering to repurchase anybody's shares at a certain price. There was no disclosure information. Our client wanted to know if this was sufficient for purposes of effecting a stock repurchase plan. My short answer was "no." A stock repurchase plan, even for a non-public company, is still subject to the "anti-fraud" rules of the SEC, meaning you have to give the seller adequate information to make an investment decision and

not omit any information that may be material. You also have to follow the SEC rule that the offering needs to be open for at least 20 business days.

The bottomline of all of this is that if you are going to do a stock repurchase program properly, it requires an eight or ten page disclosure document. It is not very expensive to do, and it is a lot cheaper than having somebody sue you over defrauding them into selling their shares.

CONCLUSION

My partners Greyson Tuck and Philip Smith and I look forward to seeing many *Musings* readers at the ICBA sponsored Mergers and Acquisitions workshop, which we will be conducting in Chicago next week. No, this is not an advertisement. It is actually sold out. They may run another one. If so, we will let you know. Very hot topic still, of course.

Have a great two weeks.

Jeff Gerrish *and* *Greyson Tuck*