GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Pennsylvania, Illinois, North Dakota, Tennessee, Minnesota, Iowa and Wisconsin!

FINRA NOTICES

We are currently assisting a bank with its reorganization into a bank holding company structure. The common stock for this particular bank is quoted on the OTC Grey Markets. There is very limited trading in the common stock, and being quoted on the OTC Grey Markets does not provide any sort of benefit for this particular bank. Instead, it is more of a headache than anything because it requires the bank to provide notice to FINRA of certain corporate activities.

As we have been assisting the bank with the FINRA reporting process, I have been reminded of the fact that for most community banks these notice requirements are more of a potential source of problems than they are any real benefit. For example, community banks must inform FINRA any time they pay a dividend or engage in certain other specified corporate transactions. The notice filing fee is $200, provided the filing is filed at least ten days prior to the corporate action. If the filing is not made on time, the filing fee increases to $5,000. I view that as a pretty hefty "fine" for a community bank failing to report a dividend to a very small number of shareholders.

If you are a bank or bank holding company whose stock is quoted on any exchange or other formal stock quotation system, keep these FINRA reporting requirements in mind. Many organizations do not know their common stock is quoted and have no idea about these reporting requirements. It is not something you want to miss considering the consequences could be very expensive.

THE FAMILY-OWNED BANK

As many of you know, our firm has had the opportunity to work with many family-owned banks across the nation over the past few decades. Over the last couple of weeks, I had the opportunity to work with a couple of family-owned banks. In both situations, the families were doing their best to do what is right for their banks. This not only included doing what is right for the family, but doing what is right for the shareholders, the community in which the bank had been in existence for a long time, and the economy of the area. I was proud of both of these families in separate situations for doing what amounted to the "right thing." Each of them could have just thrown in the towel and taken off as opposed to trying to work on management succession issues and ownership transition issues. Neither did. We will see what happens.

DISSENTER'S RIGHTS

As we reported in *Musings* previously, we had an unusual situation in connection with a Subchapter S conversion a couple of years ago. We had a couple of shareholders who "dissented" to the transaction. This means that they, for whatever reason, voted against it and wanted cash for their shares. As is always the case in connection with a Subchapter S conversion, we secured an independent (not our firm) valuation by a third-party expert as to the fair value of the shares at the time of the cash-out merger transaction. These two shareholders (who were brothers apparently) did not like the value of the shares, and each one of them thought they should be worth more. They followed the dissenter's procedures, which involved litigation in a local county court. They decided to represent themselves. The Court ruled, for a variety of reasons, that these guys were not even entitled to dissent, but more importantly, it also ruled that the valuation of the third-party expert was accurate. The Court did provide some gratuitous language in its opinion (dicta) that there was even some support in the record that the fair value should be less than the value determined by the expert.

What most dissenters do not realize in a dissenter's rights case is that the dissenter could, at the end of the court matter, get more dollars than are being offered per share by the bank, the same amount, or less. We have been involved in a number of these situations over the years where the dissenter has actually gotten less than has been offered by the bank on the basis of expert appraisal once the Court makes a determination of fair value under the statute.

This one worked out well for the bank, with the exception of the fees that they had to expend to pursue litigation. The only remaining issue in litigation is whether the dissenters get assessed the fees and costs of the litigation. We will let you know.

CHANGE IN CONTROL PROTECTION

As all of us know, we are in the midst of a consolidating industry. I do not think any of us think it will consolidate itself into oblivion (although, apparently Jamie Dimon from JPMorgan Chase would like it to). But we are in a consolidating industry. That puts some anxiety into community bank CEOs around the country. I have received three calls in the last month from CEOs who do not have any type of Change in Control protection and are looking for some. The interesting thing about Change in Control protection is it cost the bank nothing unless the bank sells. If the bank sells, then it would be considered as part of the pricing by a prospective purchaser. If you want your CEO and senior management to be secure, then do not be stingy about Change in Control protection. These documents, variously called Change in Control Agreements, retention bonuses, or by some other name, can be structured in a variety of different ways to not only protect the CEO in the event the bank sells, but also to protect the bank in the event that it does desire to do an acquisition transaction.

MERGERS OF EQUALS

We have had more mergers of equals talk over the last couple of weeks than I can remember in a long time. Banks want to combine, but they always want to combine being the "more equal." If you have 30% of the stock and the other side has 70%, are you really more equal? If you have one-third of the board and the other side has two-thirds, are you really the "alpha dog"? I do not think so, but I have seen a lot of justification that the minority side may be the "more equal." This whole concept of "mergers of equals" (as I have railed on about before in *Musings)* is really a non-existent animal. Frankly, even for the purpose of the accounting requirements, somebody has to be designated as the acquirer. Can you structure something that looks like a merger of equals? Of course. Does somebody have to be more equal? Of course. Do not let me discourage you from trying, but we all need to realize that somebody needs to be calling the shots or the transaction will not work over the long term. I have seen that first hand.

MUTUALITY

As I have expressed in *Musings* before, I think mutual institutions are great. No shareholders to worry about. I was recently with a healthy, strong, aggressive mutual meeting with the board in a board-only session regarding what they are really supposed to do to do right by their members (depositors). Mutuals, frankly, have so many opportunities that banks do not have as it relates to their communities and their members. They do not have to worry about the shareholders. They still have to worry about attracting and retaining key personnel, expanding geographically, making at least some profit, serving their communities, and the like. Those topics, however, while addressed in the context of not having to worry about shareholders or, as a practical matter, financial performance, significantly, allows mutual institutions to really "do some good."

RESALE OF "CONTROL" SECURITIES

I recently received an email from a bank holding company that has a director that is looking to sell a rather large block of stock. The holding company asked us to take a look at the proposed transaction to see if there were any issues that needed to be addressed. In the transaction, this director is going to sell about 5% of the outstanding shares. The likely purchasers are going to be the KSOP, the other directors, or the holding company.

As I have indicated in *Musings* previously, any time a director sells securities, they are "control" securities for purposes of federal securities laws. The "public resale" of control securities should be structured to meet the requirements of SEC Rule 144. Without going too deep into the specifics, this rule essentially is a safe harbor that when complied with will ensure the director is not considered to be an underwriter for securities purposes. Fortunately, this proposed transaction was not a "public resale" of securities. This makes SEC Rule 144 inapplicable.

If you have a control shareholder, which included directors, executive officers, and large shareholders, looking to sell a large block of common stock, be sure to take a look at the specifics of the transaction to determine whether SEC Rule 144 applies. If so, it is important to make sure the requirements of Rule 144 are met. Otherwise, there could be negative consequences for the seller and the holding company.

TROUBLED BANK ACQUISITIONS

I recently received a call from a banker that is considering the acquisition of a troubled bank. This banker has never made an acquisition before and was looking for advice on the appropriate process. Although he has never made an acquisition, this particular banker does have experience with troubled banks. He recounted for me the difficulties their bank had in 2008 through 2012 or so. His comment was that he "did not want to go back there again."

Having never done an acquisition, he was asking about the process. My recommendation was that the first step in his analysis be to determine whether he was comfortable taking on somebody else's asset quality problems. As I discussed with him, the acquisition of a troubled bank is really a two-step analysis. The first step in the analysis is to figure out whether you as the acquirer have the willingness to deal with somebody else's asset quality problems. There are many bankers that will answer no to that question regardless of price. If the answer to the question is yes, the second step is to figure out the extent of the problems and determine an appropriate purchase price.

This particular banker is still wrestling with the first issue of whether he is interested in doing a troubled bank acquisition at any price. I will keep you updated if this moves forward.

MORE ON FINTECHS

Our last *Musings* contained mention of an article I read on the future of fintechs. I offered a copy to anyone that was interested. Based on the responses, there is significant interest in the future of fintechs and how it is going to affect community banks.

For those of you that did not request the article, the gist of the article was that fintechs are not going to replace community banks. It essentially said that the fintechs that are successful are those that will figure out how to partner with FDIC-insured institutions, not work in lieu of or overtake them. I agree with that sentiment completely. Based on the responses I received to those reading the article, it seems the majority of community bankers do as well.

The future of fintechs and how they work with community banks is certainly going to be interesting to watch. It is also a topic that is on the mind of many community bankers.

CONCLUSION

A lot of crazy things have happened in the world in just the last couple of weeks since the last *Musings*. Stay safe. See you in two weeks.

Jeff Gerrish *and* *Greyson Tuck*