The

Chairman's Forum

Opening the door to new ideas

Newsletter

Gerrish Smith Tuck, Consultants and Attorneys

December 2017

For the year's final edition of *The Chairman's Forum Newsletter*, we wrap up our year-long focus on the evolving role of the Chairman of the Board by continuing to look at unique circumstances, ways to truly define your role and obligations, and the ways in which smaller and community banks are truly different from other financial institutions. It has been our pleasure to bring you the various ideas and topics throughout the year which are almost entirely borne out of our day to day experiences with Chairmen of the Board and financial institutions across the country. As a result, it is our great honor to be of service to the banking industry and to many of you as our cherished clients.

As we think back on 2017 and look forward to 2018, we are truly thankful for the blessings you provide to our firm and we appreciate your continuing interest in these newsletters.

Happy Reading!

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Chairman's Summary

- What is a community bank?
- When and how can a board member be removed?
- Anti-takeover planning considerations.
- Using board structure for succession planning.

What is a Community Bank?

For all the talk about the evolution of the financial services industry, modern corporate governance, the growing asset size of banks and similar thoughts, it seems somewhat interesting that there still seems to be confusion over what truly constitutes a "community" bank. We see that evidenced almost daily when we read some national publication talking about community banks. For example, we might read a headline that says "Community Bank Elects to Terminate Its Bank Holding Company". Or perhaps the headline says "Community Bank Raises $100 Million in Stock Offering". When we then read the substance of the document, we find that what one person views as a "community" bank, another person may view as a large regional or national bank. So, what's the deciding factor?

We think many of the national commentators merely focus on some asset size level for determining what is a community bank. In many of their eyes, anything smaller than Citi Group or Wells Fargo is a community bank. However, we find that many multi-billion dollar banks lose their true identity as a community bank and, in fact, the largest asset category for banks in the United States continues to be the substantially smaller banks. Furthermore, a true community bank would be defined by local ownership normally through a stockholder base of only a few hundred, not several thousand. A true community bank could also be defined by not having its stock registered as a public security and, therefore, traded on a national exchange. Rather, a typical community bank has greater control over its own stockholder base and, therefore, is not as subject to geopolitical issues impacting stock market values as organizations that ride the ebb and flow of general market forces.

So, for the Chairman of the Board, it is important to understand the type of institution you are running and from what sources you are getting your advice. If your $500 million bank has a closely held stockholder base, has local ownership and has a geographic footprint that you can drive to in one day, then maybe it is best not to look at what a multi-state, publicly held, SEC-registered company is doing across multiple states as being indicative of the strategies your organization should employ. Consider your true peer group.

When and How to Remove Board Members

Hopefully, you never have to encounter a circumstance where you are trying to determine how and when to remove a board member, but it does

happen more than you think. Circumstances may be as "simple" as an aging board member who is no longer physically capable of serving, but who has been unable or unwilling to resign from the board. Or, perhaps you might be dealing with a more complex situation of dealing with an antagonistic director constantly opposing the direction the majority of the board wants to go, causing reputational damage to the institution or some similar circumstance. The key thing in either of those situations is to know and understand what your Articles and Bylaws allow and to ensure that those corporate documents are structured in a way that promotes the best interests of the organization.

So, for example, you need to review your state corporate law (for the bank holding company) as well as your Articles and Bylaws to determine if the Board of Directors, on its own, may remove or replace directors who have otherwise been approved by stockholders. In some states, there may be a limitation on doing so unless the Articles or Bylaws specifically provide otherwise. In addition, it is normally best to articulate if there is a difference between removing a director for "cause" (perhaps which does not require stockholder action) or "without cause" which might require stockholder action. In doing so, it is best to define what constitutes "cause". Properly written Articles and Bylaws should not limit the Board of Directors' ability to govern their own circumstances and remove or replace directors as needed. If Articles and Bylaws have not been reviewed recently, you may find your provisions are outdated. So consider reviewing and updating those.

Consider Anti-takeover Planning

Speaking of making amendments to your Articles and Bylaws, it seems that we often find ourselves reminding our clients that they need to ensure that their corporate documents are in the best shape possible from a modernization and corporate governance standpoint. That comment has become even more prevalent in the current environment where, although we are not really seeing hostile acquisition offers, we are certainly seeing a tremendous rise in unsolicited acquisition offers. So, what do your corporate documents say about how you handle a proposal from another bank? For many of you, you may not know or your documents may not say anything.

Often we encourage banks to consider adding provisions to their documents that, for example, outline the specific non-financial components a board is required to consider when reviewing an acquisition proposal. This might include things like the reputation of the buyer, the impact on the community, the impact on employees, future employment opportunities for staff and similar matters.

Likewise, if a suitor cannot make any headway in talking to the board (primarily because the bank does not want to sell), could another institution solicit the largest stockholders of the organization directly without getting board authorization? Often well prepared corporate documents would require some type of supermajority (for example, 75%) vote of stockholders to approve any transaction that has not been vetted and approved by the Board of Directors. That often forces a potential buyer to deal directly with the Board of Directors. Those and other anti-takeover measures can be helpful in assisting an organization to maintain its independence and, if your organization has not updated its corporate documents recently, you might

think about doing so. If you would like a listing of possible anti-takeover measures that should be considered, send us an email and we will provide you information.

Use of the Holding Company for Succession Planning

In some of our recent newsletters, we have pushed back strongly against a current school of thought being circulated in the banking industry that the bank holding company structure is an outdated and antiquated structure that adds duplicative functions, increases costs and thwarts efficiency. Rather, we have long advocated for all institutions, but even more so for institutions less than $1 billion in total assets which are subject to the Small Bank Holding Company Policy Statement, that a bank holding company is still an appropriate tool for many reasons.

One of those reasons that is often overlooked is the ability to utilize the Board of Directors of the bank holding company as an appropriate succession planning tool. By way of example, most bank boards will meet monthly. The holding company board may only meet periodically, although many of our clients hold those on a regular (perhaps quarterly) basis. So, if you have an existing bank director who no longer has the ability or desire to take up large amounts of his or her time every month planning for and participating in a technical bank board meeting, serving only at the holding company might be appropriate. That will remove the director from the day in and day out technical bank board meetings discussing asset liability, management, new technology developments, loan loss reserve allocations, new HMDA reporting data, enterprise risk management or many of the other thousands of technical issues. However, the individual can still contribute

to the organization through strategic service at the holding company level and stay connected with the organization that he or she perhaps has served for many years and still loves.

Often times, a "promotion" to serve only at the top tier holding company level can be an appropriate board succession planning tool. It allows us to utilize the individual's knowledge, expertise and perhaps longevity with the company to continue to focus on big picture strategic issues such as whether the company should buy another bank, sell the bank, pursue new lines of business, pay appropriate levels of dividends, and other strategic issues without being burdened with the day to day tactical and operational aspects at the bank. In essence, you might think about having all individuals serve at the holding company level as the strategic board and then having a subset of that group serving as the bank Board of Directors to focus on tactical and operational matters.

So, as you consider ways to promote board succession, you might consider finding ways other than drawing a line in the sand based on the individual's age through mandatory retirement. In doing so, consider utilizing the bank holding company board as an appropriate tool.

Meeting Adjourned

Throughout the course of 2017, we have looked at the evolving role of the Chairman of the Board. That role may require you to serve as the primary advocate for stockholders, the party willing to ask difficult questions, the enforcer-in-chief to handle difficult situations, the antagonist-

in-chief to question why alternative strategies aren't pursued, the top advocate for long-term shareholder value compared to short-term management gain, and other difficult roles. Overall, we see the financial services industry, particularly for community banks, continuing to be a balancing act between shareholder value and proper corporate governance on the one hand, while remaining true to your local community and employees on the other.

We trust that in some small way, this newsletter has helped you throughout 2017 and, as we look forward to 2018, we hope to be able to pass along further information to assist you in this difficult, but rewarding role as Chairman of the Board. Wishing you blessings and prosperity in 2018.

Until next year,

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