The

# Chairman's Forum

Newsletter

*Opening the door to new ideas*

***Gerrish Smith Tuck, Consultants and Attorneys***

*June 2018*

In this month's edition of *The Chairman's Forum Newsletter*, we go a bit back to basics. We look at some very fundamental Board of Director questions such as how often your Board should meet, what is the appropriate balance of inside versus outside directors and similar questions. Often asking why your Board is structured the way it is may lead to the typical "because that's the way it's always been" response which may no longer be the right strategic answer. So, we seek to challenge some of your thinking on these basic issues.

We also provide an M&A update on a key question for potential buyers and sellers regarding the benefit of a privately negotiated deal versus a public auction. We just completed a successful Community Bank Merger and Acquisition Conference in St. Paul, Minnesota earlier this month and these types of core questions were addressed, so we thought it might be important to pass along some of these concepts in the coming months.

Happy Reading!

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## Chairman's Summary

- Maybe the holding company Board should be different from the bank Board.
- Seek to promote Board diversity.
- Consider the appropriateness of out of territory directors.
- Schedule meetings to meet your current needs.
- Reconsider mandatory retirement ages.
- M&A update: a private deal may be better than a public auction.

## Fundamental, But Important, Director Issues

As we travel around the country and see multiple types of community bank and bank holding company Boards of Directors and multiple ways of conducting their business, we are reminded that there really is no one given way to ensure success. However, often times we see new, or even experienced, Board members struggle a bit with some of the most basic and fundamental questions about Board service and governance because their organization has been locked into doing things the same way for so long. Accordingly, we thought it might be beneficial to outline some of our thoughts based on our experience with some fundamental Board governance issues that Chairmen should take to heart in leading their organizations.

These may not work for every organization or you may find variations on these that better suit your organization, but if your organization is doing things differently than we outline, consider if you are perhaps simply doing things the same way because you have always done them that way. Let's look at some fundamental questions.

Should the holding company Board be different from the bank Board? Our take would be, no, the holding company Board should not necessarily be structured to be intentionally different from the bank Board. That being said, though, there is no problem with the composition of the holding company Board being different from the bank Board. In fact, it might be helpful to have the composition of those two Boards be different since each Board handles different functions. For example, as Board members age, you might ordinarily consider retiring them from the bank Board or putting in place mandatory retirement or some other type of process. However, as an option, you might continue to allow those individuals to serve only at the holding company Board level to focus on long-term strategic issues without being bogged down in the day to day operational elements of a bank Board meeting such as asset liability management, technology committee service, etc.

Should we seek diversity on our Boards of Directors? Generally speaking, yes. We are not proponents of promoting diversity for diversity's sake, but many banks will find that their organizations reflect the old joke that typical Boards of Directors are "male, pale, stale and frail". So, a healthy dose of diversity can go a long way, but that diversity might take one or more of many different types of forms. It could mean diversity of age, it could mean diversity of gender, it could mean diversity of race, it could mean diversity of county residence, it could mean diversity of business background, it could mean diversity of risk takers versus risk mitigators, it could mean diversity of big picture dreamers versus practical realists. If all of our Board members tend to look, act and think alike, there is a much greater risk of only hearing or pursuing one strategy or viewpoint which, if it turns out to be the wrong strategy or viewpoint, can lead everyone to following the person in front of them "off the cliff" and thwart any success we might otherwise have. As Chairmen, refuse to allow your Board to be populated with individuals who look, act and think just like you do.

Should we allow "out of territory" directors? Generally speaking, an organization is benefitted by having directors who are members of the local markets they serve. However, exceptions might be appropriate if you can tap the expertise of someone who lives out of market, but can still add value to the organization through their service as a director. However, if that individual is unable to be present in the local market, to attend meetings locally and constantly requests to participate only via telephone conference, videoconference or some other electronic means, then perhaps the individual should serve only as an advisory director and not as a full voting member of the local bank or holding company Board of Directors. The same would hold true for any existing director who perhaps spends the majority of their time at a second home at the beach (assuming your bank is not located at the beach) and is no longer active in the daily affairs of the local community. Some electronic participation may be appropriate, but the overwhelming majority of attendance needs to be required to be made in person.

How often should the Board of Directors meet? We continue to see organizations around the country that vary the frequency of Board meetings of the bank and holding company. The overwhelming majority of banks will typically hold bank Board meetings once a month and holding company Board meetings quarterly. However, we occasionally still see some bank Boards meeting once a week, twice a month and occasionally see a bank Board meeting every other month. In our opinion, this is one area where following the standard practice of most banks is probably what is best. Meeting less often than monthly is probably okay for a shell holding company, but is probably not frequent enough in order to appropriately exercise fiduciary obligations for the oversight of the bank. On the other hand, meeting more often than once a month may promote micromanagement and inefficiency by the Board of Directors and may signal to your management team a lack of trust and confidence. Moreover, if you are appropriately using your committee structure, which by its nature will meet more often than the Board meetings, then the Board meetings should not necessarily have to be held more than once a month. Take a fresh look at what you are doing and consider if changes should be made.

What is the proper balance between the number of "outside" Board members versus "inside" Board members who are part of the management team? It is a best practice for corporate governance purposes that at least a majority of your Board of Directors be outside directors independent of bank management. However, we recognize that in many community bank situations, particularly with family-owned or closely held banks, that may not be the best or most appropriate structure. But consider that one of the primary fiduciary obligations of your Board of Directors is to provide supervision, oversight and to occasionally act as a check and balance against your management team. Therefore, a Board of Directors with an appropriate balance of both insiders and outsiders for your unique circumstances should be sought.

Should we have a mandatory retirement age? The answer to that question depends on how you are willing to answer another question. That other question is "Are you willing to deal with reality and confront difficult situations?" By that question, we mean are you willing to tell a director who is one of the largest stockholders of the bank that, because of their current health, they will no longer be recommended to serve on the Board? Are you willing to tell a director who is less than technologically savvy that they are going to have to learn how to use an iPad to review Board materials in the future which will only be provided in an online secure Board portal? Are you willing to tell a director that it is no longer proper for them to come to meetings unprepared without having reviewed the Board package, without having reviewed loans to be considered and otherwise not participating through asking questions or giving feedback at Board meetings?

As you can maybe see, if you are honest with yourself that your organization would find it difficult to take those types of steps, then perhaps developing an arbitrary age and suggesting that all directors will be required to rotate off of the Board at reaching that age can be beneficial. However, if your organization is willing to handle those types of difficult circumstances and perhaps even go beyond that to the next step of conducting Board evaluations in order to determine on a yearly basis that each director is pulling their weight, then the idea of setting an arbitrary age limit seems silly. Most of the time, when a mandatory retirement age is set, that number is somewhere between 70 and 80 years of age. Yet, during the last presidential election, the final two candidates (Trump and Clinton) were each going to hold the distinction of being the oldest elected first term President. Regardless of your politics, no one ever suggested that either one of those candidates could not fulfill the duties merely because of their age. So, why would we ask a 72 year old director to exit the Board merely because of his or her age? So, consider what would work best for your organization by answering these difficult questions honestly. And if you do use a mandatory retirement age, don't "grandfather" certain individuals while others are subject to the mandatory retirement age. If it is good for one, it is good for all.

## ***Bank M&A: Privately Negotiate a Deal Versus Marketing Process***

Not surprisingly, we are currently helping many banks and Boards sort out the M&A minefield. For a bank that is properly managing its fiduciary duties, attuned to corporate governance issues and following a well-structured strategic plan, often as much work may go into the planning part of an M&A transaction as does the actual execution of it. Along those lines, one of the questions we often get from a bank that might be a potential seller is whether they should conduct a full-blown marketing process of the bank and simply put it on the auction block or whether, in the exercise of their fiduciary duties, they can negotiate privately with only one potential buyer who has expressed some interest.

Both strategies can be appropriate given the circumstances, but, importantly, the good news for many Chairmen and their Boards is that there is no absolute auction duty required if you are thinking about selling that mandates you simply tell the world you are for sale and then requires you to sell to the highest bidder. In fact, for many community banks, the better strategy is to seek a privately negotiated transaction with a willing buyer, who is not looking to be a “bottom feeder” when it comes to pricing the deal, and where the buyer brings substantial benefit to the transaction, monetarily and otherwise. Conducting a privately negotiated transaction may, in fact, have many benefits which include reducing overall time and cost to complete a deal, providing a better economic value to stockholders of the selling institution because the buyer will pay a “preemptive” price in order to avoid a bidding war, better results for employees and customers because the selling institution can choose its mate who shares a similar banking philosophy, value system and organizational culture.

So, from a potential buyer’s standpoint, that is why it is always a pretty good strategic step to let other organizations know if you have some general interest in them. This is often done in a non-threatening, non-intimidating manner with the simple statement of “If you ever consider selling or merging, we would love to have a chance to talk to you before you consider any other buyers.” You would be surprised how many deals actually get completed because a bank ultimately decides to sell and the first call they ask us to make is to a friendly competitor of theirs who suggested they might have some interest a couple of years ago. So, navigate the M&A minefield successfully and you will wind up producing economic benefits for your stockholders.

## ***Meeting Adjourned***

From fundamental, but important, questions to the developing M&A landscape, there continue to be questions that arise for Chairmen and Board members. Any time you encounter any of these where there may be cause for confusion or differences of opinion, don't hesitate to contact us and we will be happy to give you some candid feedback.

On the M&A side, we completed a very successful Community Bank Merger and Acquisition Conference in St. Paul, Minnesota earlier this month with approximately 50 community bankers from across the country represented. Some buyers, some sellers, some lookers. But everyone was searching for more information and ideas. It seems best to keep all your options open!

Until next time,

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