
GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Wisconsin, Minnesota, Arkansas, Michigan, Texas, Tennessee, Georgia, and Oklahoma!

THE SMALL COMMUNITY BANK

Through our consulting and law firms we represent community banks of all sizes. These community banks range from small institutions with \$30 million or less in total assets to large organizations with multi-billion dollars in total assets. We were recently visiting with one of those clients on the smaller end of the scale. They wanted to keep their bank independent in their community for the long term but realized things were not going to get any easier. In fact, the CEO expressed some satisfaction that they were “still in existence.” We began to discuss the possibility of putting together a consortium of small community banks to provide some common services to each of the banks. This of course would involve services that a small bank could not afford on its own but needed none-the-less.

Although we have been in this type of discussion with small community banks many times in the past, we have rarely seen this come to fruition. The environment may be right for this currently, however. It could be the economic sense of a consortium of small banks sharing needed services may override egos and concern about losing customers to competition. We will see.

FIDUCIARY DUTIES VERSUS INDIVIDUAL CONCERNS

I recently received an interesting telephone call from a client that is a director and shareholder of a fairly troubled bank holding company. This particular holding company is considering a couple different strategic options relative to the potential sale or recapitalization of the underlying bank. These available strategic alternatives are an interesting dichotomy for this particular individual. One of the available strategic alternatives is probably a little bit better for the shareholders but not quite as good for him on an individual basis. The other strategic alternative is the opposite - it is not quite as good for the remaining shareholders but puts the individual in a better position.

My client asked for my advice regarding his director fiduciary duties compared to his individual rights as a shareholder. Although it is a tough situation, my overall comment to the individual was that one does not totally suppress the other. It is not as though this individual's fiduciary duty as a director makes his individual concerns invalid. The opposite is also true. However, I also reminded my client that he has potential liability for a breach of fiduciary duty as a director, where the same is not necessarily true for any "breach" of his individual interests.

HOLDING COMPANY DEBT

As many of you know, our firm is of the opinion that bank holding company debt is often one of the best ways to raise cash for one of a number of different strategic transactions. The bank stock loan market, which was essentially dead during the height of the recession, is now very active. There are multiple lenders out there that are looking to make bank stock loans.

Over the past couple months we have reviewed the proposed terms of a number of different bank stock loans. One of the newer features of these loans that has not traditionally been included is essentially a non-usage fee on a line of credit. We have seen a number of different proposed term sheets where a line of credit includes a 15 to 50 basis point fee for any available but unused credit.

We have had several clients ask us about this fee. Our advice is that you ought to fight back against them. These are somewhat new to the bank stock loan world, and our hope is that they do not become an industry standard for this type of credit product.

ACQUISITION NEGOTIATIONS

We are currently in the process of helping several different clients negotiate bank acquisition transactions. On some of these we are representing the buyer, and on others we are

representing the seller. What has struck me as being interesting about each of these negotiations is that they are generally being fought harder than what was typical three or four years ago. I attribute this to the improved condition of the underlying banks. Put simply, the underlying banks are generally healthier today than they have been in the past, so the seller is not required to sell the bank. This also increases the buyer's desire to complete a deal, since the underlying bank is generally a better asset than it has been in the past.

Overall, the industry has been and continues to be strong. This is leading to better banks and more interesting acquisition negotiations.

DIVIDEND STRATEGIES

I was recently involved in a planning session with a board of directors that gave some pretty good discussion to dividends. This bank is a very strong community bank with good earnings, good asset quality, and the like. The bank has plenty of capital and plenty of capacity to increase their dividends. The board's discussion regarding dividends was not whether dividends ought to be increased, but by how much. Some of the directors wanted to essentially maximize their dividend paying capacity by increasing dividends as much as possible. The other directors thought a more tempered approach to be better. The central argument on this side of the table was that an increase in dividends was appropriate, but if they maxed the dividends out and then at some point in the future got in a position where the dividend needed to be reduced this would look bad for the holding company and bank.

The ultimate resolution was essentially a combination of these two. The declared dividend was a little bit higher than the tempered camp wanted, but it was not completely maxed out. This left the board room to increase the dividend but also provided some protection in the event future years were not quite as good as this year. I thought this to be a smart compromise on behalf of the board.

THE FRIENDLY CREDIT UNION

"The friendly credit union" - words I never thought would come out of my mouth! I was recently facilitating a planning session for a well-run, high-performing community bank that has a number of credit unions in its community as competition. It also has one that has become very "friendly." The credit union has actually referred loans to the bank in the past, particularly those non-conforming or fixed rate mortgage loans the credit union did not want that the bank was happy to portfolio. I am aware of several community banks that refer credits they don't want

(for a lot of reasons) to their friendly credit union, but I had not seen the road running the other way. It must be a new trend.

CEO VISION

Most of the community bank CEOs we work with have a vision for where they want the bank to go over the long term. Generally, that vision aligns with the board's direction and vision. That is not always the case, however. We suggest that the board and management have a good discussion as to the long-term direction for the bank. If the board and management visions are not aligned, then they either need to get aligned or somebody needs to move on, either the board or the management team. If the community bank board and management do not have an alignment of purpose, then it will be a constant tug-of-war even for the smallest items and very difficult to move the community bank forward.

LARGE PERCENTAGE SHAREHOLDERS

Does your bank holding company have a shareholder who owns a large percentage of the stock? If so, have you planned for what happens if that shareholder needs to liquidate his or her stock (or the estate does)? If not, you need a plan. When allocating capital strategically, the board needs to consider whether it needs to keep some "powder dry." This could be in the nature of excess capital at the bank level that could be divvied to the holding company to redeem shares, leveraging ability at the holding company where the holding company can borrow money to redeem shares, or even an ESOP that is sitting on a lot of cash or is unleveraged. Whatever the alternative for the redemption of the shares, the board needs to assess the real possibility that those shares will need to be redeemed and the means to do so if the board wants to keep the bank independent. This will likely require having some reasonable discussions with that large shareholder and/or his or her family.

MERGER AND ACQUISITION WORKSHOP

As *Musings* readers know, our firm provides financial advisory and legal services in connection with merger and acquisition activities. Over the last several years, the three of us have also conducted a Merger & Acquisition Workshop sponsored by the Independent Community Bankers of America. One such Workshop will be held on October 29th and 30th in downtown Nashville, Tennessee. This is a very hands-on workshop and is perfect for those banks that are contemplating getting in the acquisition arena, either as buyers or sellers. It is not

for big banks. It is for community banks - to help them understand not only the process, but the issues. The Workshop is ideal for CEOs, CFOs, and outside directors, or members of the Merger and Acquisition or Strategic Committee.

The link to the registration is set forth below. We hope to see you there.

[Mergers & Acquisitions](#)

CONCLUSION

We are mid-September and nearly at the end of the third quarter of 2018. Hard to believe! To those of you getting hammered by Hurricane Florence, we send our thoughts and prayers. Stay dry.

See you in two weeks.

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