The

Chairman's Forum

Newsletter

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys

December 2018

We hope this newsletter finds you in a condition of having survived Christmas and in anticipation of closing out 2018 and looking forward to a positive 2019! During this sometimes "interesting" week between Christmas and New Year's, there often is either a huge rush to get things done by year-end, a lot of pressure to close out things or to finally finish things you had started or sometimes it's a bit of a casual week to get the body, mind and spirit ready for the coming new year. We trust that you find a comfortable balance between those two extremes.

As we reflect on 2018, we hit a couple of key issues that have developed throughout the year to reemphasize those and point toward some new ideas and initiatives for 2019. It is our honor to have you read our materials and for many of you we appreciate your business this past year and look forward to seeing many others of you at the upcoming Chairman's Forum in Naples, Florida. Let's all make 2019 a wonderful year!

Happy Reading!

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Chairman's Summary

- Are you going "far enough" on M&A?
- Should we add a __________ to the Board?
- Be aware of forward-looking supervision.
- Do you separate the role of Chairman of the Board from CEO?

Are You Going "Far Enough" on M&A?

At a recent strategic planning session, a Chairman of the Board somewhat wondered out loud "Are we going far enough on M&A?" When I asked him to explain a little bit of his thoughts on that comment, he referenced the fact that throughout 2018 and really even in the prior year his organization had been well positioned to pursue growth through acquisitions. The Chairman indicated that, not only had they been well positioned, but they had let it be known that they wanted to be a buyer, they had received contact from a few banks and some individuals marketing banks for sale, and had even taken some of the preliminary steps to review marketing packages of a selling bank and conduct some due diligence.

When we suggested that it seemed as though they were on the right track and heading in the right direction, his comment was that they did not think so because they were highly disappointed that they never seemed to get past those preliminary stages. Even though they had submitted Letters of Intent on a couple of potential transactions, they never got a call back, were never invited to conduct extensive due diligence and no one ever pursued serious negotiations with them. So, the Chairman's concern in asking if they had gone "far enough" was to ask if, in terms of structure and pricing, they were not doing enough. In essence, were they trying to price the deals too modestly, were they not willing to give the sellers key things the sellers might need or desire (such as retaining certain employees, keeping the charter, etc.)? Now, without knowing more, you cannot really say in the abstract that the organization, the board or the Chairman in particular were not going "far enough". But it was our opinion that the Chairman's comment pointed out a flaw in their M&A process that we often see among community banks. That flaw is not adhering to the principle that we often espouse which is to be willing to pay for value added.

For example, if we can demonstrate that paying a certain price for a target bank will improve your earnings per share and return on equity over the next five to seven years beyond what you can produce without doing the transaction, does it matter that the proposed acquisition price is something that "sounds" excessive such as two times book value? We often hear Chairmen and other board members make comments to the effect that "we are not going to pay anybody two times book value". Why? If it is going to produce more positive economic benefits for your organization than not doing the deal, what difference does it really make? Our guess is that it is the fear that you are overpaying and that no one else is paying that great of a price. However, like this organization, if you find you are always coming up short and never getting the invite to actually be the purchaser, then realize that these other organizations are willing to price up deals in a way that truly gives the seller great economic value, but also produces positive returns for the buyer. So, make sure you are "going far enough" in your financial analysis and your willingness to pay what the market will bear.

Should We Add a __________ to the Board?

Go ahead, fill in the blank above. Our guess is that at some point during the past year, there may have been discussions around this topic. We have had boards of all different sizes in all parts of the country ask us this question in one form or another and the answer to fill in the blank varies from bank to bank. Historically, we have been asked questions such as whether the board needs to add a female to the board, or add a minority to the board, or add another insider or outsider to the board. The list could go on and on. Most recently, we were asked by a Chairman whether the organization should consider adding a millennial to the board.

So, you can see that it is a bit of a universal struggle on finding the right composition for your Board of Directors. Interestingly, in many of those circumstances, our answer when asked the question is "No". What we mean is that you should not put someone on the board just because they check a box related to gender, race, age, occupation, stock ownership, etc. Rather, what you need to do is add board members who meet whatever needs you have for the organization and find the best person that accomplishes that regardless of what label they may wear. So, for example, if you are needing someone with more financial background, a CPA or someone like that to serve on your board, find the best possible candidate regardless of labels. If you do the search and that turns out to be a female minority in your market who could also serve as a great source of referrals to your organization, then great! If you truly want to begin a new push toward technology that you have never done and begin a marketing process to attract millennials to your bank, then certainly it might make sense to add a person of the millennial age group to your board. While our Boards of Directors are becoming more diverse in terms of age, gender, race, and other elements that promote diversity, that is happening by necessity because our boards are becoming more reflective of our communities and our customers. Take that approach toward populating your boards, not merely trying to meet some preconceived quota. But if you look around the room and you meet the old adage that your entire board is male, stale, pale and frail, it is probably time to consider a change for 2019.

Be Aware of Forward-Looking Supervision

Many of you may be aware of what we would describe as a "shift" in regulatory emphasis. Historically, our boards have been trained to the regulatory focus of examining your bank as a "snapshot in time" as of a particular date. So, for example, a group of examiners might walk into your bank today and review your bank as of December 1, 2018 using financial data as of September 30, 2018. On that basis, it becomes a "snapshot in time" of how you looked on those relevant dates and to then give the board and management constructive criticism (ha ha) on concerns for the organization.

But, as Chairmen, you should be aware of a significant shift in how examiners conduct their examinations. What we are beginning to see is more of a movement away from the "snapshot in time" theory and a focus on "forward-looking" supervision. By this, we are hearing the regulatory agencies tell boards to stop merely focusing on the "rearview mirror" and rather begin to look "over the dashboard" to begin anticipating the next issues coming for the board and organization. In doing so, we are beginning to see regulators criticize banks not for how they are operating in the current environment, but for perceived weaknesses that the regulators think may happen if a certain set of circumstances perhaps could unfold sometime in the future given some things that may or may not happen economically, regulatory-wise, interest rate-wise, etc. So, yes, you are now not only charged with governing the organization, but you must be a bit of a fortune teller as well and anticipate what is coming down the road and start preparing for it now.

So, make sure your board is aware that their primary job is no longer historically reviewing what just happened the past quarter, but it needs to begin to be more forward focused on the coming quarter and what is likely to happen. Take this simple example, is your board more concerned about loans that are 30 days past due or are they more concerned about what loans might go on the watchlist in the future if economic circumstances change? In today's environment, they must be focused equally on both scenarios.

Do You Separate the Role of Chairman of the Board From the CEO?

We have hit on this topic a number of times by questioning whether the roles of the Chairman of the Board and the CEO ought to be separated. The reason this keeps coming up is because in various forms around the country you are beginning to see organizations take adamant stands that the role of the Chairman of the Board and the CEO should be split. Then, you will read a follow-up article from two other companies that say under no circumstances should those roles be separate and rather they should be combined. Recently, this issue has raised its head again.

It was reported that Regions Financial, a large regional financial holding company, had separated the roles of the Chairman of the Board and Chief Executive Officer for the first time in five years. With the roles of Chairman of the Board and CEO combined, the organization had properly selected an individual to serve as the "lead independent director" which is a structure we recommend if the roles are combined. In this circumstance, that individual who was the lead independent director (apart from the Chairman/CEO) has now been elected as Chairman of the Board separate from a recently elected CEO. Somewhat interestingly, these moves were made under the heading of "succession planning" and it seems that this particular organization has a history of sometimes having combined roles and sometimes having separate roles. In fact, the organization went out of its way to explain that splitting the roles of the Chairman from the CEO was not the result of a shareholder proposal, meaning that there was not some type of corporate governance push to accomplish this. Rather, the company’s statement indicated that the decisions regarding the board leadership structure were “the responsibility of the Nominating and Governance Committee of the Board”.

So, different organizations continue to take different approaches and some organizations, like this one, may alternate between having the roles combined or separated depending on the individuals to serve succession planning needs, etc. There is no one correct answer. Do what is best for your organization, but if the roles are combined, a lead independent director should be appointed in most circumstances.

Meeting Adjourned

We are happy to report that the Chairman’s Forum in Naples, Florida in January is practically a sell-out. We believe there may still be a few spots available for registration, but we were recently advised that the hotel room block had been filled. However, at the time of preparing this newsletter, we received notification of a couple of rooms coming open, so if you still have an interest in attending you may follow this link and you may be able to find a few last minute rooms and registration. Otherwise, we can put you on a waiting list. If you would like to attend, but are having trouble with hotel information, please contact us directly and we can provide you some alternative locations or try to help you in other ways.

https://barret.ws/landing/chairman/

For those of you unable to attend, we will post an update on some of the discussions in an upcoming newsletter.

We thank you for subscribing to this newsletter and we appreciate the many comments we receive throughout the year regarding its form and content. We hope it is useful to you in creating value for your organization and we wish all of you a happy and prosperous new year.

Until next time,



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