GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Florida, Minnesota, Tennessee, Wisconsin, California, and Illinois!

SOMEBODY DIDN'T LISTEN

As most *Musings* readers know, starting a couple of years ago, we have had off and on problems with some of our closely-held community bank clients and the friendly federal regulators with respect to bank expenses. The regulators have, on various occasions, taken the position that personal expenses for the controlling family or ownership group are being paid by the bank when they shouldn't be, and our firm has warned that this is an issue to be taken seriously. It appears a banker in Wisconsin did not heed our warnings. He was just indicted by a federal grand jury and charged with bank fraud and misapplication of bank funds. The allegations indicate that when he was President and CEO of his bank, he defrauded the bank by "expensing the bank for luxurious personal travel and entertainment for himself, his family, and various friends." If anyone wants a copy of this press release announcing the indictment, please let me know.

Heed the warning. Justify what you do through your community bank, and do only what you can justify for your community bank.

CHANGE-IN-CONTROL

We deal with a lot of acquisition topics in *Musings*, but rarely do we focus on the issue of change-in-control itself. Of course most acquisitions involve a company, not an individual, either merging with a target bank holding company or target bank or acquiring the stock of the bank holding

company or bank. This does not implicate change-in-control requirements. Generally, Federal Reserve approval is involved if a holding company is the purchaser.

Occasionally, though, we have individuals making acquisitions of significant blocks of stock or even inheriting significant blocks of stock. The general rule is that if you are going to acquire a significant interest in either a bank holding company or a bank, you must provide prior written notice to the appropriate federal and state regulatory agency. In other words, if you acquire the bank or the shares without giving the appropriate agency sufficient prior notice - filing an application and letting them review and approve it - then you will likely have violated the Change in Bank Control Act. This can result in serious civil money penalties and removal from banking.

The only exception to that rule, as a practical matter, is in connection with an inheritance or a redemption of stock by the holding company, which may cause an individual shareholder to trigger a change in control without their knowledge. In those circumstances in particular, the federal agencies generally allow an after-the-fact notification. In other words, since prior notification cannot be given in those circumstances (i.e., death or redemption is out of the shareholder's control), then the friendly federal agencies, enjoying their adept use of common sense, allow an after-the-fact notice. The notice does need to be filed within 90 days after the event, however. Keep in mind that any notice, as we have indicated in prior *Musings*, will be vetted significantly by the federal agency.

THE CASH ACQUISITION

Last week, our firm closed a cash acquisition of about a $500 million bank. Generally, transactions of that size are part-cash/part-stock. In this one, the clients wanted cash, and the purchaser was able to deliver. The transaction also went off without a hitch. This is primarily due to the fact that both sides of the equation (i.e., the financial advisors and the lawyers on the part of the buyers and on behalf of the sellers) all knew what they were doing. It makes for a much smoother transaction if you have experienced help. Keep that in mind for your next deal.

DEAL STRUCTURE

We have been talking a lot about acquisitions in the pages of *Musings* during this period of consolidation. One important issue in any acquisition is how the deal should be structured. Generally, tax and accounting issues come into play. The three major choices are to structure the transaction as an acquisition of stock, a merger of the entities, or a purchase of assets and assumption of liabilities. We have done a number of whole bank transactions over the last couple of years that were structured as purchase and assumption transactions. This is how you would normally think a branch transaction

would be structured. The buyer simply agrees to assume all the deposit liabilities and then obtain enough assets to fill in the asset side of the balance sheet via cash, securities, fixed assets, loans, and the like. The difference between the liabilities assumed and the assets purchased is generally the premium paid on the transaction.

The benefit to a buyer structuring a whole bank acquisition as a purchase of assets and assumption of liabilities transaction is that it protects the buyer from any unknown or contingent liabilities. It also, of course, allows the buyer to re-depreciate the assets.

DUE DILIGENCE

We recently advised a community bank "seller" client with respect to an Indication of Interest it received from another community bank. At the initial stages, the concern of any community bank seller, of course, is the confidentiality of the transaction and how that might be breached during the due diligence process. To mitigate that risk as much as humanly possible, we generally establish a data room. The seller uploads documents into the data room, and the buyer reviews documents from the data room. We typically organize the data room to correspond to the buyer's due diligence request (i.e., governance documents, regulatory documents, loan documents, and the like). This whole process minimizes, and in some cases eliminates, the buyer's need to do on-site due diligence. If follow-up, onsite due diligence is required, it is generally much more limited in scope and is certainly not conducted during business hours. We have found that utilizing the data room has been an effective method to keep the transaction confidential.

TRANSACTION CLOSINGS

We have often referred to the actual closing of an acquisition transaction as the most anticlimactic part of the deal. Back a number of years ago, transaction closings were a big to do, with the buyer and seller coming together typically in some hotel conference or similar room and actually signing a bunch of documents. This was usually followed by appropriate celebratory dinners, which were always fun. These days transaction closings are very different. Essentially everything is done electronically, with all of the documents exchanged beforehand and held "in escrow" until the time of closing.

Recently we closed another very large acquisition transaction in which we represented the seller in the deal. This closing was a prime example of a closing being anticlimactic. The lawyers on both sides of the deal knew exactly what they were doing, so the transaction was basically "closed" two to three days before the actual closing date. We had exchanged all of the documentation and

simply held the documents electronically and in escrow until Friday, at which point the deal closed. It all went off very smoothly and without much fanfare. That is certainly the way we like them!

THE CRAZY REGULATORY REQUEST

Recently we were chatting with a long-time client and good friend on a number of issues. During that conversation, he relayed what we think may be one of the most bizarre and crazy regulatory requests we have ever heard. This banker indicated they had an old set of table and chairs in their lunchroom for the employees to use during breaks. Recently one of the chairs broke when an employee went to sit in it. The bank decided it was time to replace the old table and chairs. Rather than throwing them out, they offered them up to the bank employees. The bank agreed to sell the table and chairs to an employee for $100, which was agreed to be an appropriate purchase price.

This bank provided notice of the sale of the table and chairs to their state regulator since this particular state requires notification to the regulators of a transaction between the bank and its employees. Shortly after providing the notice, this banker received a call from one of the higher ups at this state bank department asking that the bank provide pictures of the table and chairs to the state bank department so they could make an independent determination that the $100 sales price was an appropriate value for the table and chairs! Talk about fighting the good fight on the regulatory front!

We pass this along for a couple reasons. First, we thought many of you would get a kick out of the regulators taking this type of approach to this situation. Second, we think it is reflective of the current regulatory environment. Certainly this is a little extreme, but we have plenty examples of the regulators looking to justify their existence. Most we see as appropriate. Some we do not.

STOCK REPURCHASE FUNDING

We are currently working with a couple different holding companies on stock repurchase programs. Each of these stock repurchase programs is voluntary and allows the shareholders the opportunity to sell their shares at a fair price in a timely manner in the event they would like to do so. One of our holding company clients is using all of the items available in the arsenal to fund the repurchase - current holding company cash, bank "excess capital," holding company debt (through an established line of credit), and the possible sale of additional shares. Essentially this holding company has a number of different funding alternatives available, and the combination of what they will use will largely depend on the shareholder response to the repurchase program.

If you are thinking about different ways to fund share liquidity, the list above should serve as a useful guide for your available alternatives. There may be one or two other ways that stock repurchases could be funded, but those would be pretty unique circumstances.

STRATEGIC PLANNING DIFFICULTIES

We recently visited with a particular community banker about strategic planning. This community banker mentioned to us that all of their prior strategic planning sessions had been pretty good. Their chief complaint was that many of the "great ideas" discussed and adopted at the planning session never came to fruition. He said that they would spend time talking about great things, but once they left the planning session it seemed those fell by the wayside pretty quickly.

We inquired of this community banker about their strategic planning action plan. He related that he did not know what we were talking about. He said most of their strategic planning sessions were followed by some type of brief report, but they did not have any type of "action plan" or other document that set forth the action items to be accomplished, the person responsible for achieving the action item, and the required completion date.

We informed this community banker that, in our opinion, the action plan is the most important part of the strategic plan. It is critical for the specific action items to be listed in order to establish accountability for completing the action items. The action plan is the best safeguard we have been able to come up with in regard to the difficulty of actually accomplishing the strategic action items adopted at a planning session.

THE PODCAST

As many of you know, all of us at the firm are affiliated with the Barret School in Memphis. This is a Graduate School of Banking housed at Christian Brothers University in Memphis. It is named after Paul Barret, who was a West Tennessee banker whose estate provided a significant endowment to the School.

Barret School provides podcasts that can be found under Main Street Banking: A Podcast for Community Bankers. Philip Smith has been an episode guest, and we listened to an episode the other day on CECL, Current Expected Credit Losses implementation. It was probably the best 20 minute summary of CECL that we had heard. We suggest you take a listen.

CONCLUSION

It is now mid-May, and we are optimistic that the snowfall has ceased in virtually every part of the United States, at least for a while. We hope as the summer begins to emerge that each of you take the time to enjoy some outdoor time with the family.

Also, don't forget about the Mergers & Acquisitions Workshop to be held in St. Louis on June 18th and 19th. Below is the link for more information. See you in two weeks.

Mergers & Acquisitions Workshop

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