GERRISH'S MUSINGS

Jeffrey C. Gerrish
Philip K. Smith
Greyson E. Tuck
Gerrish Smith Tuck
Attorneys/Consultants
700 Colonial Road, Suite 200, Memphis, TN 38117
♦ Phone: (901) 767-0900 ♦ Fax: (901) 684-2339 ♦
♦ Email: jgerrish@gerrish.com ♦ psmith@gerrish.com ♦ gtuck@gerrish.com ♦
Website: www.gerrish.com

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Dear Subscriber:

Greetings from "working remotely"!

COMMUNITY BANKS CONTINUE TO EVOLVE

Over the past couple weeks we have talked with a number of different community bankers that have rapidly moved forward along the technology spectrum. This is happening mostly out of necessity. There are many community bankers that are now meeting with other bankers, clients, and us electronically, where they have never done so in the past. We have had plenty of these meetings over the last several weeks through either GoToMeeting or Zoom. We have found these electronic meetings to be effective for meeting with community bank boards of directors or senior management teams or both, particularly on more narrow (i.e., not day-long) topics. These "meetings" generally last an hour or two, including discussion, and have involved the following topics:

- What do we do about the regulators when the pandemic ends?
- How do we raise capital in this environment and going forward?
- What's the best way to create liquidity for our shareholders?
- How involved is it to do a stock repurchase plan, and should we in this environment?
- What's the minimum level of capital we should maintain, and why?
- How do we attract and retain key employees?
- Is an ESOP or KSOP right for my bank?
- Is it time to buy another bank or sell ours?

We have addressed each of these topics through one of the electronic meeting platforms. Although face-to-face would generally be preferable, we have found that the efficiency, lack of travel time, and travel expense to the bank—as well as the ability of all participants in the meeting to continue to participate,,ask questions, and the like—has made these meetings a pretty darn good second choice.

If your board needs some strategic direction/discussion, please let us assist, even if from a (social) distance.

ELECTRONIC BOARD AND SHAREHOLDER MEETINGS

In view of the current coronavirus pandemic, we have received multiple emails and calls from clients asking us to review their community bank and bank holding company Articles and Bylaws and state law with respect to holding their board of directors meetings electronically, and for several, holding their shareholders meeting electronically. At least for the duration of the pandemic, electronic board meetings would seem to be appropriate. Also, if your shareholders meeting is coming up anytime soon, an electronic shareholders meeting would be appropriate as well.

Please let us know how we can assist you, your community bank, or your holding company in making sure that these matters are appropriately documented and authorized so that the results of the meetings can be effective.

THE CEO TRANSITION

One of our long-time clients and good friend of the firm recently underwent a management transition. At the end of February, this community bank's long-time President and CEO, who had been with the community bank since its inception over 25 years ago, stepped down as President and CEO. The new President and CEO took the reins March 1st. Talk about a first month on the job!

The success story behind this management transition is that the board and management team had been planning for it for a long time. This was not anything that came unexpectedly. Instead, the plan to complete the transition has been in place for over ten years. We see this as a big win for the community bank because, even in this period of significant uncertainty, the community bank is being led by an individual with significant experience in community bank leadership.

Notwithstanding all of the current challenges posed by COVID-19, it is important to keep longer term strategic issues in mind. The short term will present challenges, and if we do not take care of the short term there will be no long term. However, the pandemic has not changed the fact that the ultimate responsibility of directors and officers is to enhance shareholder value over the long term. Assuring for a qualified management succession plan is certainly a part of that.

ESOP ISSUES

We have received numerous inquiries from our community bank clients that maintain ESOPs and KSOPs with respect to valuation issues for 2020, particularly during and post the COVID-19 pandemic crisis.

The issue of course is that bank holding company stock values (the stock owned by the ESOP or KSOP) have been falling (along with all other stock values) since year-end 2019. From an ESOP standpoint, there is IRS statutory authority that a valuation as of the last day of the preceding year can be used to value the shares for the current year. In other words, a valuation for year-end 2019 (before the pandemic and the economic problems) could be used for the entire year of 2020 and comply with law. The law also allows an appraisal to be obtained during the current year (i.e. 2020) to be used for terminating employees and for employees who have the right to diversify at ages 55 and 60.

Keep in mind, in view of all of this, that the Trustees of the plan have a fiduciary duty to operate the plan in the best interest of the employees. Typically using the year-end 2019 valuation will result in a higher price, so there are some conflicting issues.

If anyone needs any advice on this particular matter as it relates to their ESOP or KSOP, please don't hesitate to contact us.

STOCK REPURCHASE PROGRAMS

Is now the time to redeem your holding company stock? Of course the large banks have halted stock redemptions (and some will be required by the new law), but for smaller community bank holding companies now is probably a good time to redeem shares. As many *Musings* readers are aware, in a voluntary share redemption, the board can set the price anywhere it deems appropriate. A forced redemption, however, needs to be priced at fair value. We are working with a couple community bank clients in different parts of the country that are moving forward with restructuring the ownership of their holding company through a forced transaction. This is either going to be through a reverse stock split, or, more typically, a cash-out merger transaction. When you force a shareholder to take cash, virtually every state law requires the shareholder to be paid "fair value" for their shares. We anticipate it is likely that that valuation at fair value, based on what is happening in the marketplace, will be significantly lower than it was even two months ago. This would be a good time to execute on either a forced or voluntary transaction. If you need any further information, please let us know.

TAKING ADVANTAGE OF OPPORTUNITIES

We recently received an email and had a Zoom meeting with a community bank client who was very interested in the issue of whether now is the time (i.e., right in the middle or at the end of the pandemic) to consider how to take advantage of opportunities that will present themselves. This community bank had an abundance of capital (even in the current environment) and wanted to discuss strategically what is the best way from an opportunistic standpoint to strategically allocate that capital. Should they buy another bank? Should they redeem shares? Should they increase the distribution to their shareholders who may need the money during the pandemic? All those issues were addressed in a couple hour interactive video conference with the board of directors.

Is, in fact, now the time for your community bank or holding company to be thinking about taking advantage of opportunities, either during this pandemic or once it is over? Life and community banking will go on and be successful. The question is who is going to come out on top when all this shakes out.

COMMUNITY BANK M&A

At the end of February, the community bank M&A market was best described as being "active to very active." Our firm was working on a number of different deals on each of the buy and sell side. Obviously, quite a bit has changed in the last 30 days, and we have had a number of community bankers and directors ask us about the current and near-term future for the community bank M&A environment.

In terms of the environment today, it is not active. Those deals that were under contract prior to COVID-19 generally continue to move forward, although at somewhat of a slower pace. For those deals that were "in the works" about a month ago, most seem to have taken a "wait and see" approach. These deals have not fallen apart completely, but the parties have recognized that there is a lot happening in the world these days, and pausing or moving transactions forward at a much slower pace is prudent.

As it relates to the future of community bank M&A, we see deal activity returning to active levels similar to what was experienced at the end of February. The driver of the deal activity and the types of deals that are seen depend on the character of the COVID-19 recovery. If the economic recovery is quick, we think you will see an M&A environment that is largely opportunity driven by community bank buyers looking to capitalize on acquisition opportunities. If the recovery is an extended recovery with a more severe economic fallout, we think the M&A environment will be more controlled by struggling community banks that have decided a sale of the institution is a better alternative than remaining independent. This will resemble a market more closely to that of around 2011 through 2014. If we are placing bets, we think the former to be more likely than the latter.

SBA PAYCHECK PROTECTION PROGRAM

On March 27th, President Trump signed a $2 trillion coronavirus stimulus package that contained numerous governmental responses to COVID-19. The Bill was approximately 900 pages in length. Any summary of the Bill would be well beyond the scope of *Musings*. However, one of the items of note in the Bill is the Small Business Administration Paycheck Protection Program ("PPP").

The PPP is an approximately $350 billion pool of money that is intended to provide eligible businesses assistance to maintain operations and keep employees on the payroll. As you might expect, there are a number of specific terms and conditions related to the program, many of which have not been fully resolved at this point. The SBA intends to provide additional information soon. However, it is important to note that the program contains loan forgiveness where the loans can be forgiven on a dollar-for-dollar basis assuming certain conditions are met.

We were recently contacted by a community bank Chairman who believes his community bank may qualify and is looking into participation in the PPP. They asked for our thoughts. We have taken a look at the issues, and our general concern is that this bank, as well as others, may not qualify for participation in the program. Based on our initial reading of the program, we believe every borrower will be required to certify that the loan is necessary because of economic uncertainty caused by COVID-19 and would be applied to maintain payroll and make similar required payments. Given that banks deal in cash, we are not certain whether this certification can be met. Again, it will depend on the specifics of the SBA program, the language of the required certifications, and the SBA's guidance on its interpretation.

If you are thinking about participation in the PPP, one recommendation we have is to make sure to consider the reputational risks associated with participation in the PPP. Like it or not, we think it entirely possible that a bank's participation in the PPP, if made generally known to the public, could be viewed similarly as participation in the TARP CPP. Some ten or so years later, that program is still being talked about as a "bailout," notwithstanding the fact that the U.S. Government made a boatload of money off of those investments.

If you have not looked into the PPP, you may want to do so. If you think it might make sense for you, be sure you are thinking about all the various angles. There may be some reputational risks. If you do participate, make sure you also think about your future actions in terms of dividends, share repurchases, and the like. It may be that participating in the PPP and then turning around a short time later and using "excess capital" to repurchase shares or pay dividends may further exacerbate the reputational risks.

LENDING LIMIT ISSUES

In the last day or two we have received numerous calls and emails from clients about the possibility of their bank making SBA loans under the recent law signed by the President last week that will provide, among other things, "payroll protection" for small businesses. The question is whether these loans are being included in the lending limit of the bank. Although information contained in *Musings* does not constitute "legal advice" as such, the preliminary analysis of this issue involves determining what legal lending limit applies. Those of you who are FDIC or Fed member banks that are state-chartered, state law provides the lending limit. For those of you who are national banks, the National Bank Act provides the lending limit. Although the states are all different, there are generally many similarities (it is easy to check) because many of the state lending limit laws were based on the provisions of the National Bank Act. For a national bank, the general rule (subject to numerous qualifications) is that the guaranteed portion of a loan that is guaranteed by the "full faith and credit" of the United States Government is excluded from the loan amount when calculating the lending limit.

We are happy to help your bank analyze these lending limit issues, particularly under the state law or the National Bank Act, for your specific situation.

COVID-19 WEBINAR

There has certainly been no shortage of opportunity to participate in webinars over the last three or so weeks. Most national and state trade associations, banking schools, and other service providers are providing plenty of opportunity to further understand COVID-19 and its effects. Our firm was recently asked to present a webinar for a trade association group that analyzed how COVID-19 effects community banks from a number of different perspectives. We talked about everything from HR to governmental programs. The webinar was about an hour and a half, and we had pretty extensive PowerPoints. Please let us know if you would like a copy of the PowerPoints. We are happy to provide them.

CONCLUSION

The last two weeks have certainly been interesting. In order to protect our employees, staff, and their families, "before it was fashionable," our firm had the employees and staff working remotely. The professionals were used to working remotely since, representing community banks in all 50 states, we all traveled extensively pre-pandemic. Turning on the "working remotely" switch for the staff was fairly easy for us. As most all of you know, the consulting and law firms are based in Memphis, Tennessee. Although Memphis is known for its mild weather in the winter, occasionally there is snow and ice.

Because of that, for years, we have had an Inclement Weather/Working Remotely process. We flipped the switch on that a couple weeks ago with no interruption in service of any type.

The goal for all of us, our employees and staff, is to stay healthy and safe. We wish the same for you, your families, and your banks' staffs.

See you in two weeks.

Jeff Gerrish *Philip Smith* *Greyson Tuck*

