THE

Board Chair Forum

Opening the door to new ideas

NEWSLETTER

Gerrish Smith Tuck, Consultants and Attorneys

June 2020

As we approach the end of the first half of the year, many of us are taking a deep breath and hoping that the second half of the year is not as tumultuous as the first six months. But, through the various twists and turns of the last six months, we have continued to learn some truths about our financial institutions and about the role of the Board and its Chair. Key among those is that change is constant and that the Board Chair must often be the agent for change, the voice for modification of strategies where needed, and the primary supporter for the organization to continue pursuing strategies that create shareholder value.

As part of those efforts, we have seen the Board Chair, by necessity, leading their organizations to update or modify strategic plans, force their organizations to begin looking at new ways of doing business, and primarily being willing to simply accept change that happens.

In this month's edition of the Newsletter we will share with you some ways in which we see boards dealing with these issues, as well as some suggestions for future operations. We hope that you will find this information useful and if we can help you further in any of these matters, please let us know.

Happy Reading!

Jeffrey C. Gerrish | Philip K. Smith | Greyson E. Tuck

Gerrish Smith Tuck
700 Colonial Road, Suite 200
Memphis, TN 38117
Phone: (901) 767-0900; Website: www.gerrish.com

THE

Board Chair Forum

Opening the door to new ideas

NEWSLETTER

Gerrish Smith Tuck, Consultants and Attorneys

June 2020

Board Chair's Summary

- Are Your Performance Metrics Appropriate?
- Home Office Versus Main Office
- Strategic Planning When Your Plans No Longer Work
- Are You Prepared for Permanent Changes?
- Community Banking Commentary

Are Your Performance Metrics Appropriate?

The Board of Directors is primarily charged with setting the institution's overall risk profile. As part of that process, various metrics on overall performance come into play. For example, what are your minimum and maximum tier 1 capital ratios? What type of return on equity is appropriate to keep shareholders happy? What type of asset growth rate can you expect in your market? Adding some specificity to the definition of those is critical to allow your management team to understand how they can define if they are being successful in their job. For example, if you request that your management team grow assets by 10% each year over the next five years in order to achieve incentive bonuses, is the growth rate based on anything logical, is it simply based on the rate you would need to achieve in order to match peer, is it a ratio you think makes the regulators happy? We need to give serious consideration to those types of measurables in order to prevent those performance metrics from being viewed by the management team as a disincentive because they are not realistically achievable. We have always found that you will, in fact, get what you incent (growth, earnings, etc.) so be sure you know what you are asking for and how you are measuring it.

Recently, we were working with an organization that was reevaluating the types of metrics that they use to hold their management team accountable. In particular, consideration was given to two elements - the minimum amount of capital with which the Board was comfortable, and the targeted return on equity that was being requested. Because the Board was conservative by nature and generally wanted management to maintain an additional capital comfort "buffer" beyond what might otherwise be expected, an interesting discussion ensued as to whether ROE should be calculated on actual equity (based on the generous capital comfort buffer management was maintaining), or on a lower standardized benchmark of equity more in line with what other organizations are doing. The idea was that, for example, they could measure appropriate return on equity comparing income to a 10% capital ratio, even if the total equity was more than 10%, given that the Board was generally instructing management to maintain an additional capital cushion because of their conservative nature. This board felt that requiring the higher level of capital would otherwise make the ROE number less than what it might normally be, and in some ways, artificially depress the ROE calculation. Therefore, they benchmarked return on equity against a more standard equity in order to determine how they were performing and in reviewing incentive compensation.

We thought this represented a unique way of looking at how you evaluate your metrics and whether or not they represent some true benefit to the organization, and if they appropriately drive incentive performance for your management team. So be careful how you structure your performance metrics.

Home Office Versus Main Office

Over the past year in various parts around the country, an interesting question has arisen with regard to office location for banks headquartered in more rural markets. The problem these banks have is the ability to recruit and retain top talent for senior and executive management positions, given the more rural location. As a result, at some of the planning sessions we have conducted there has even been discussion of what historically would have been unthinkable. That is, should we move the main office from our original rural location to the more metropolitan area close by in order to achieve greater growth, attract and retain top talent, and other benefits?

As you might imagine, those types of discussions are often met with anger, sadness, skepticism, and open and direct opposition. Newer board members may not appreciate the legacy issues confronting the organization with its long time main office in the rural markets. Most of the time there is a battle waging between what is economically expedient, what is strategically important, and what is emotionally difficult to give up. So what's an organization to do?

Our belief is that there is a way to accomplish multiple goals without destroying the legacy of the bank. If circumstances make the potential "relocation" of the main office the best long-term strategic move, but you are torn about doing that compared to your history and legacy, consider making a move without making a move. By that, we mean that there does not need to ever be a formal announcement that the main office has relocated. In fact, we have some clients that have simply changed their terminology and have referred to the legacy office as the "home office," even though the "main office" (where the CEO, the Chief Financial Officer, the Operations Department, and other senior executive officers are housed) may now have been re-designated into a more metropolitan area. The idea is that you do not have to physically move or even officially re-designate your main office. Simply allow the "home office" to remain designated as the headquarters of the bank for all of the legacy purposes, but feel free to move your executive offices to the new location being built in the more metropolitan area. By doing that, you will accomplish both purposes without stepping on as many toes.

Strategic Planning When Your Plans No Longer Work

Recently we delivered a presentation around this topic, “Strategic Planning When Your Plans No Longer Work.” The major thrust of the presentation was that in these unusual times, all of the wonderful planning in the world that you did in early 2020 or in 2019 may have gone right out the window. So what should you do? The answer is simpler than you think, but is often difficult for community banks to implement. You simply modify your plans on the fly.

Strategic planning is not intended to create a static document that binds the Board and Management for the next 12 months or more. Rather, it is intended to be a dynamic document for a dynamic company, and as circumstances change, you should not hesitate to toss out your irrelevant plans and craft new ones.

In fact, the very idea that you might have to modify your strategic plan throughout the year is one of the primary reasons we encourage boards of directors to include the current strategic plan, or action plan items from the strategic plan, at least quarterly on their board agenda. Keep the idea of the modification of your strategic plan separate, though, from any potential discussion about modification of your budget. The budget is what it is and probably should not be adjusted, but the actual strategic plans should.

Are You Prepared for Permanent Changes?

We have been asked often in recent weeks whether we think the changes that we are seeing in the community bank business model resulting from COVID-19 will be permanent. We believe, in many areas, things may have changed permanently in ways that we cannot yet anticipate. Take, for example, life before and after the events of 9/11. Many of you, we are sure, can remember going to the airport with your family, every single person in the family going through security to the gate, and then everyone hugging a member of your family goodbye and waving to them from the terminal as they boarded the plane and took off, and then everyone exiting back out through security. After 9/11 that changed and only passengers, not families, were permitted through security. Most of us, at that time, thought "that's a great safety measure that we must be willing to accept in the short term until things improve." So, we probably expected that within a year everything would return to normal. It has been nearly 20 years and we never went back to having everyone go through security.

So, consider whether we may be facing similar permanent changes as a result of COVID-19. Will employees now be demanding the opportunity to work remotely? Will we feel the need to permanently enact elements of social distancing? Will our board meetings continue to be conducted through electronic video conference or will we go back to lengthy monthly board meetings in our boardrooms where food is served, we are passing around copies of policies and everyone is touching them, and similar activities? Will you feel comfortable letting large groups use the community room that you added onto the bank? Will attendance at large gatherings like churches, athletic events or the company Christmas party become things of the past? We believe organizations are going to need to be prepared for a changing workforce and changing circumstances, perhaps in ways we are not yet able to ascertain. A confident board chair, willing and able to lead through times of change with an organization willing to adapt quickly, will find smooth sailing. Organizations resistant to change may have change forced upon them in ways that are disruptive to the organization. So look for ways to embrace change that continues to promote long-term shareholder value.

YouTube

In last month's edition of *The Board Chair Forum Newsletter* we directed you to a temporary YouTube channel we had set up where we began posting our *Community Banking Commentary* videos. We appreciate the great response and we are happy to announce we now have our permanent and formal Gerrish Smith Tuck YouTube channel set up. You will find the original *Community Banking Commentary* on it, along with updated information we have recently added. You will find more information about the next *Community Banking Commentary* below.

Please subscribe to our YouTube channel (it's free) and we hope you will find the information posted there, including the brief video commentaries, as a helpful way for you to stay engaged with us. If you have a topic you would ever like for us to address, please send us a note, and if there is enough overall interest, we will address your question specifically.

Community Banking Commentary

For the next installment of our *Community Banking Commentary* video series, we wanted to direct you to a recent panel discussion webinar that Philip Smith and Greyson Tuck handled for the Barret School of Banking. This discussion on "The 'New Normal' of Community Banking" covered a wide-ranging number of issues. While the entire webinar is over an hour long, on our YouTube channel you will find a clip addressing the first fundamental question of what the new normal might look like. You can access the latest video on our YouTube channel at the following link:

https://www.youtube.com/channel/UC8NUEl2_RDd9Qzc-ZUjUD1g/featured

Meeting Adjourned

We believe it is time to take a deep breath and exhale and realize that we all somehow survived the first six months of the year. Community banking still matters to our communities, community banking remains alive and well, and the business climate still remains generally favorable. So, we hope you stay on task and continue to lead your organizations in positive ways, and we hope our videos and correspondences continue to provide you with sense of direction and purpose.

Until next time,



Jeffrey C. Gerrish   Philip K. Smith   Greyson E. Tuck

Gerrish Smith Tuck
700 Colonial Road, Suite 200
Memphis, TN 38117
Phone (901) 767-0900
Website: www.gerrish.com

HOW TO CONTACT US:
If you have questions or comments about the newsletter or would like to ask a follow-up question, please email Philip Smith at psmith@gerrish.com.