



THE

Board Chair Forum

Opening the door to new ideas

NEWSLETTER

Gerrish Smith Tuck, Consultants and Attorneys

August 2020

In this month's edition of the Board Chair Forum Newsletter, we review how well community banks are doing, the fiduciary obligations involved in merger and acquisition considerations, and offer the steps in the Anatomy of a Community Bank Deal. Additionally, we consider the often difficult question of trying to decide when a conflict of interest actually exists for your Board of Directors. Just because a director has a connection to someone does not automatically mean there is a conflict. Finally, we take a look forward into 2021 and what the outlook might be. We offer up a link to our current Community Banking Commentary video to see and hear from us directly on our thoughts about keeping your organizations healthy and smart.

With all the oddities going on in the world these days, we hope you and your community bank are continuing to prosper. Anytime we can be of assistance or just lend a thoughtful ear to your circumstance, please do not hesitate to reach out to us.

Happy Reading!

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Board Chair's Summary

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Is Your Community Bank Still Doing Well?

As the Board Chair, if someone were to ask you how the bank is doing, could you tell them that the bank is still doing well? In a recent discussion with a Board Chair, he relayed to us that as he is describing how his bank is doing in casual discussions with friends and business colleagues, he finds himself facing surprise from individuals when he indicates that the bank is actually very stable, very strong, earnings are still pretty good, and that they are continuing to look for opportunities. We see that holding true for many of our clients. Perhaps somewhat surprisingly to those outside of the community bank field, most of our community banks remain fairly stable.

That does not mean that we are not concerned about the future or trying to be smart with what we are doing, but it reflects the strong leadership at the Board of Directors level that emerged over the past few years as a result of the recent financial crisis coupled with smart strategic planning. The result of those efforts were most community banks beginning to refocus on core profitability, and not

take on excessively risky ventures. In fact, as we have outlined in previous newsletters, we often encourage the Board Chair to be the primary proponent of ongoing risk mitigation if you feel you have a very strong entrepreneurial Board, who is otherwise always looking for new challenges and, conversely, to be the agent for change driving your organization to look at new and different opportunities if you feel your Board overall is perhaps too conservative or risk-averse. The point being that a well-managed Board by the Board Chair has elements of both risk-taking and risk aversion, and appropriately debates both sides of those issues and comes to the best conclusion for the organization. By doing so, most of our community banks have remained healthy and stable.

Now that we feel better, the cautionary statement. We were recently in a meeting that involved certain regulatory personnel. Those individuals were in agreement that most community banks are still stable, yet their concern is that any problems that began originating with COVID or other areas in the first and second quarters of the year will not begin to show up on our financial statements until the fourth quarter of 2020 at the earliest. Therefore, their advice to this particular client, which we think is relevant for all of us, is to not be lulled into a false sense of security because things are currently stable, but continue to stress test your loans, monitor performance, and continue to focus on true core organizational value.

Price Doesn't Have To Be the Only Consideration

When a Board is trying to exercise fiduciary duties, particularly in an acquisition scenario or a potential sale, but certainly in other areas also, there should be a recognition that fiduciary obligations are not always 100% aligned with economic numbers. For example, does an organization that is seeking to sell itself have to sell to whoever comes along as the highest bidder? The answer in most cases is no, that is not required. A Board appropriately exercising its fiduciary duties might very well turn down an offer that is slightly more favorable

from a pure economic sense in order to accept an offer from a buyer that would be a better “fit” for the organization in terms of the impact on the community, the customers, the employees and other factors.

In light of that recognition, we have often had some interesting discussions with the Board Chair and other board members who are considering whether to engage in a potential transaction. One group was concerned that they did not want to have to face a situation where they solicited bids and then the highest bidder might be a credit union where they did not want to sell to the credit union. We certainly recognize the problem with a community bank selling to a credit union because of the brotherhood of community banks where the acquiring credit union would then be a tax-advantaged competitor against fellow community banks. That is why it was important for the Board to understand that they had the absolute fiduciary right, if not obligation, in considering acquisition offers, to be specifically focused on other community bank buyers and what they could bring to the table for their organization compared to investor groups, credit unions, or other nontraditional buyers.

Our hope is always that community banks choose to stay independent but we recognize circumstances do not always allow that. But, if your goal is to sell your organization in a way that creates value for shareholders and also helps protect the community banking industry you have worked so hard for over many years, understand your fiduciary obligations will not automatically require you to sell out to someone bidding one dollar more than someone else.

Anatomy of a Community Bank Deal

In the past we have published a brief overview in a simplistic readable format of the general steps in a bank acquisition transaction. This “Anatomy of a Community Bank Deal” outlines the various key steps in the process and if you are considering being a buyer or seller, it might help you understand the general

categories of steps. If you would be interested in receiving a copy, please email us and we will send a copy to you.

When Is a Conflict Not a Conflict?

Would it be surprising to you for us to say that directors should avoid conflicts of interest? Of course not, that goes without saying. In fact, as the general statement goes, a director should not only avoid conflicts of interest, but often need to go the extra mile of avoiding the appearance of conflicts of interest or the appearance of impropriety. However, we have found, in our experience, that sometimes that concept is a little harder to interpret in real situations than you might otherwise think. Some examples are easy. Should the Chairman of the Board vote to approve a loan to his brother's business where the director also has a part ownership? Of course not. Should a director use her influence as a member of the local school board to withhold funding from a local school district unless the district deposits money at the bank where she is also a director? Clearly not.

However, recognize that avoiding a conflict of interest does not mean having absolutely no connection or no information about another party. In fact, the reason directors are often asked to serve on the board of a community bank is, in fact, because of the myriad of contacts that they have. So, if you are a CPA serving on the Board and one of your clients has a loan coming before the Board for approval, you might choose not to specifically vote on the request to avoid the appearance of a conflict, but the mere fact that the borrower is a client does not automatically present an actual conflict. In fact, in that scenario the CPA, through his or her knowledge of the borrower, cannot reveal confidences directly related to confidential tax or financial information of the borrower, but certainly if the CPA noted that in financial statements submitted to the bank the borrower failed to disclose a tremendous amount of additional debt that the accountant is aware of, the accountant would have an obligation to make that known to protect the bank.

In any of these situations you can see how there could be different circumstances that change the outcome or the determination of a conflict of interest, but keep in mind that merely having connection with someone is not automatically a conflict. Be careful not to isolate your directors or prevent them from speaking during board meetings or voting on matters, where appropriate, merely because they possess information that other board members may not possess.

What Is Your Next Strategy?

As we move into the last four months of the year, what is your next strategy? As Board Chair, are you already thinking about 2021 (or probably more accurately hoping 2020 will finally end)? Are you beginning to strategically plan now for what you are going to do the following year or are you making plans for what to do in the next couple of months? Candidly, for many of our clients the decision has already been made to simply ride out the rest of 2020 and focus more on 2021 for your next strategic move. For some that may be an appropriate strategy but for others it may not be. At a recent strategic planning meeting we conducted, one director said that the bank needed to specifically take the mentality of not following the herd. By that, she meant that if everyone else is simply going to ride out the storm for the rest of the year, then it was a golden opportunity for this bank to find acquisition opportunities or look for other positive steps. You might consider the same thing for your bank.

Similarly, what are your thoughts about the upcoming Presidential election? Should your strategy be based on who wins that election? If there is one thing the last Presidential election taught us, it's that Presidential elections can be unpredictable. There was no national polling of any relevance that, even the day prior to the election, showed Donald Trump with a relatively easy win. As a result, we recall many planning sessions where strategies were being developed in

one form or another for the likelihood of Hillary Clinton being the next President and the expectations of what type of impact that might have on the bank for better or worse. As a result, we think it is safe to say that you should not base your strategy around the Presidential election in and of itself.

Likewise, none of us planned for how we would handle a global pandemic, how long we would keep the lobbies closed, if we would set up appointments for lobby hours, or similar concerns. Did you ever think previously about setting up VPN networks to allow your staff to work remotely, to ask your employees not only to work remotely but to wear masks if they did come to work, to install new hand sanitization stations throughout the bank, etc., etc., etc., etc.! Yet, even though we did not plan for that, we have survived and thrived. So, if we can handle a global pandemic and still be strong, we can handle any circumstance from a Presidential election, regardless of which party wins. Therefore, plan your strategies on sound principles, not on the hope that your favorite candidate wins.

Meeting Adjourned

As you begin thinking strategically about what you might do in 2021 and how you will finish out the year of 2020, you might think about a comment we are hearing a lot these days that, while intended to generally apply to COVID-19, can apply to how you run your organizations as well. That comment is, “Stay Healthy, Be Smart.” For more information on that concept, see our latest GST Community Bank Commentary video. You may follow this link: https://www.youtube.com/channel/UC8NUEI2_RDd9Qzc-ZUjUD1g. Also, feel free to “like” our videos and subscribe to our YouTube channel. We will continue to post those videos periodically to keep you updated on what’s going on

and where we are in the world, and as you will see from the current video, there may be times we have to reach out briefly from some anonymous hotel in an unnamed city around the country! Keep in touch.

Until next time,



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