THE

Board Chair Forum

NEWSLETTER

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys

January 2021

Welcome to a new year! January has certainly been off to a hectic start on our front and we are sure for many of you as well, but, in reality, isn't that good news? After a slight pause over the holidays, it seems like everyone has now caught their breath, and they are moving forward rapidly with plans in 2021. Likewise, we continue to see a lot of positive outlook among community bankers and the Board Chair with many of our clients and we think that bodes well for the outlook in 2021.

Many of you know, and a number of you attended, the live, in-person Board Chair Forum we hosted in the middle of January in Naples, Florida. What a wonderful opportunity it was to see a number of familiar as well new faces from all over the country getting out of hibernation, getting down to a wonderful location, and exchanging thoughts, ideas, and best practices among those who sit in the Board Chair position, serve as outside directors, or serve in senior management positions. As always, we appreciate the Barret School of Banking for hosting that event. As a result of the Forum, in this initial edition of the Board Chair Forum Newsletter for 2021, we are going to highlight some of the key comments, questions and concerns that were raised, as well as present an outlook on some new factors for you to consider. We hope you will find this engaging as something other than "What do we do about COVID?" and give you a positive outlook on the year to come. If we can help, 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

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Board Chair's Summary

- Renew Your Focus on Shareholders and Their Needs
- Structure and Formality May Not Be a Bad Thing
- Recognizing the Need for Change is Step One
- A Traditional Focus is Still Appropriate

Renew Your Focus on Shareholders and Their Needs

Notwithstanding COVID, notwithstanding national political events, notwithstanding your local market conditions, notwithstanding PPP, and notwithstanding any number of other outside concerns, the need to promote shareholder value and otherwise meet shareholder needs still knocks at the door every day. In our conference in Naples, there were many questions about appropriate ways to create liquidity if your stock is otherwise illiquid, how to manage an aging shareholder base, how to deliver shareholder value in an increasingly technological environment, and other similar concerns of the Board Chair, directors, and other leaders at the bank. As a result, we believe the focus of many organizations in 2021 will be on providing straightforward and simple value to shareholders, including, specifically, shareholders that may have a desire for liquidity, by offering stock repurchase programs.

In looking at stock repurchase programs, we generally advise privately held financial institutions that they have the ability to structure a stock repurchase program that is targeted toward the need, rather than simply having a broad based program for all stockholders. For example, your bank holding company could conduct a stock repurchase program targeted only toward out-of-state stockholders or stockholders that do not have a loan or deposit relationship with the bank, or something similar. By structuring it in this fashion, you may have the opportunity to provide liquidity to shareholders that are no longer local to your organization or who inherited the stock or have moved out of the area, and who simply want cash. On the other hand, the stockholders who remain in the organization have an increased overall shareholder value, and typically the funding of the repurchase can be done with existing capital resources or modest borrowings through your holding company.

One of our clients recently took an unusual approach of asking shareholders in a questionnaire if anyone had a need or desire to sell shares. Their expectation is that they would have no one interested and therefore would not need to go through the process of implementing a repurchase program. Much to their surprise, they received quite a bit of feedback from people indicating a willingness to sell some or all of their shares at the right price. So, in a volatile market it does appear there could be some pent-up demand wanting to acquire shares, and those kinds of transactions can be extremely beneficial to the overall performance metrics of the bank (earnings per share, return on equity, and the like) while providing cash opportunities to selling stockholders. Truly a win-win situation. Attorneys note: while it is ok to send out a general question to stockholders asking if they might be interested in selling, that kind of simple letter cannot form the basis for a formal offer to repurchase stock by the Company. A more detailed document would be required.

If your bank holding company's stock is illiquid, a recent Clients & Friends Memorandum put together by our firm regarding Liquidity Strategies for Illiquid Community Bank Stocks may help. Please let us know if you would like a copy.

Structure and Formality May Not Be a Bad Thing

We are beginning to see a recurring problem among our clients as the average size of banks continues to increase and as banks continue to remain profitable. The problem is that the traditionally small, closely-held, or family banks are continuing to see their asset size grow, yet their internal structures remain locked into the ways of doing things from the past. We really see this in banks of all sizes. For example, if a bank has now grown to more than $500 million in total assets, where it was only $100 million a few years ago, wouldn't you think that would create some internal change? Similarly, if your bank now exceeds $1 billion in total assets, would you still operate it the way you did when it was $250 million?

For most community banks the struggle is how to add additional internal processes and structures while still maintaining a community bank touch and feel. The comment we typically provide to the Board Chair and other leaders of the bank is that, by necessity these days, your organization needs to be more internally formal and structured, yet continue to maintain your outward high touch and personal contact. For example, start at the Board of Directors level and look at the Board committees you have. These days, practically all banks could benefit from an audit committee, a compensation committee, or even a technology committee. Likewise, as your bank continues to grow, you may find the need for a full-time Compliance Officer rather than merely having one of your other bank employees attend some compliance courses on the side.

Yes, there is additional cost involved in adding these types of internal formal structures, but the failure to do so, in our opinion, can hinder the long-term development of the organization because you have an entity that is trying to grow and be vibrant, yet its processes and internal structures are holding it back by being geared for a much smaller organization. Of course, this sometimes presents its own unique challenges. One client commented to us that they would develop a board-level technology committee, except they did not have anyone on the Board really qualified to serve on that committee. Well, do you think that means the committee should not be established, or do you think perhaps that adding that expertise to the Board might be a better strategy?! If 2020 taught us anything it's that the need for change can be thrust upon us at any moment. Take the lead in your organization and make the internal changes that are necessary to keep your bank competitive and moving forward.

Recognizing the Need for Change is Step One

Let's be honest, most people serving in the position of the Board Chair are not necessarily forces for change in their organization (although we have suggested that for a number of years). So, let us give you a slight break on that. The person serving as the Board Chair does not necessarily have to be a driving force for material change in the organization, pointing out all the latest technology and features that the bank needs to adopt. In fact, the Board Chair might not even be well-versed in what change needs to happen. But we continue to believe that even if the Board Chair or other directors are not necessarily the agents for change, they should be the agents for *recognizing* the need for change as it arrives. We think last year and this year will continue to bring that to the forefront as everything from hours of operation, allowing employees to work remotely, a renewed focus on more drive-up or drive-thru facilities rather than expanded lobbies, and other realities continue to reshape the community banking and general banking landscape.

We will admit, though, that even recognizing the need to make a change can be difficult because all of us are blinded to generational changes, shareholder and customer changes, evolving expectations and other concerns. Try this example. We recently heard someone say that people should stop emailing things to people under 35 years of age and suggesting that they print them off for one use or the other. That person's comment is that no one under 35 has a printer! We will have to admit, we have been guilty of that ourselves, or have had our kids ask why we told them to print something off and keep it in a file! So, we are all learning and it certainly is an evolutionary process, whether it is with your children, or your bank and its customers and shareholders. Recognizing the need for change, though, is step one. Perhaps the Board Chair should be the person asking if change is needed in particular areas to force the discussion of those potentially critical items.

A Traditional Focus is Still Appropriate

Let's balance the discussion of change and new technology for a moment. At our Board Chair Forum in Naples, there was also a clear undercurrent that was an appropriate counter to all the talk about new things, new technology, new changes, responses to COVID, remote working, etc. That undercurrent was that there is a clear desire and a need to continue to focus on traditional community bank and general financial institution operation. In essence, the engine running in the background needs to continue to be appropriately structured, well attended to, generating profitability and the like, even in the face of the external changes going on around it. So, for example, there was discussion about the continuing need to be in a bank holding company structure. We highly recommend that structure, and if you are in that structure, we highly recommend it for many of the purposes we have discussed elsewhere, such as using it to repurchase shares and create liquidity. If you are a closely-held organization, the Subchapter S tax structure is certainly still a vital organizational structure that ought to be put in place to create economic benefit, reduce taxes, and thereby create more shareholder value. Growth and expansion in new markets through physical locations, loan production offices or branches is not dead, but the style of those physical locations may look different going forward.

We still must focus on high touch service that large or regional organizations cannot deliver, but recognize there are different methods to do that these days such as through the development of peer-to-peer payment platforms, the use of video chat with bank officers through your phone, and other mechanisms. The need to raise capital may still be an issue for many organizations. So, use the holding company structure to leverage capital into the bank in an efficient manner, perhaps consider subordinated debt, or even evaluate bringing in new investors with a stock offering, if appropriate. A continuing focus on core safety and soundness will also continue to be vital under a new presidential administration where the regulatory focus is likely to change as well. So, for all the talk of the "new," don't lose sight of the traditional.

Meeting Adjourned

So 2021 is off and running! Indeed, it appears to be running at a pretty fast pace. Many of our clients have already expressed concern that the pace of everything seems to be a bit quicker this year, even in the face of lingering COVID problems. So, throughout the year we will continue to expand on the various topics that were discussed in the 2021 Board Chair Forum and try to bring more engaging content to you. As such, we are going to be looking in future editions at what we are describing as an emerging concern of financial institutions. That concern is confronting and distinguishing the concepts of remaining independent versus remaining relevant. For years most of us have focused primarily on the aspect of ensuring long-term independence, which we hope all of you still make as your primary goal. But, let's consider a shift in our focus so that we are not merely remaining independent and focusing merely on how to survive, but changing our focus on being independent and remaining relevant and thriving in the changing environments. We look forward to bringing further commentary and discussion to that topic in the near term. Happy 2021 and please let us know how we can continue to help you.

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.