



THE

# Board Chair Forum

*Opening the door to new ideas*

NEWSLETTER

*Gerrish Smith Tuck, Consultants and Attorneys*

*March 2021*

As we close out the first quarter of the year, it is hard to believe we are actually closing out the first quarter of the year! But as the ice and snow melt and we are beginning to see the new growth of spring and spring colors, we would suggest that is reflective of what we are seeing in the community banking sector of the industry as well.

We have begun to travel more and visit more community banks across the country and we are beginning to see an uptick in positive outlooks, a focus on the future, initiation of new growth plans, implementation of new strategies, and the first signs that at least somewhere in the future we can see the glimmer of things returning somewhat to normal. So, while we continue to manage our current processes in light of the global pandemic and other headwinds confronting our industry, it seems as though for the first time we are able to see a bit of the horizon in the distance and can chart our courses appropriately.

We take a look at some renewed areas of interest by the Board Chair this month and comment on some interesting situations we have seen that we hope you may find relevant to your circumstance. Also, don't hesitate to share with us any unique or interesting stories you have as well, and perhaps we can (anonymously) include them in a future edition!

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](http://www.gerrish.com)*

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*Gerrish Smith Tuck, Consultants and Attorneys*  
March 2021

## *Board Chair's Summary*

- ◆ The Board's Job is Oversight, Whatever That Means
- ◆ Reconsidering Subchapter S
- ◆ Board Chair Duties versus Presidential Duties
- ◆ Executive Committee versus Executive Session

### *The Board's Job is Oversight, Whatever That Means*

One of the terms that is thrown around a lot, particularly by the regulators, when dealing with the Board Chair and with the board members, is "oversight." Take a look at almost any bank failure that has occurred and read the exam reports, or look at the ways the regulators fault the directors, and you will see this term tossed around quite a bit. A recent article noted that regulators had determined that the primary reason for a bank failure in Kansas was "inadequate board oversight." So, how can a Board be guilty of failing to exercise oversight?

If you use this as one example, you will see that the regulators faulted the organization for "long standing capital and asset quality issues." There was also an indication that the bank "lacked the requisite skills and experience to ensure appropriate loan underwriting and credit administration." There was also an indication that the organization failed to comply with provisions of a consent order. So, are those areas where the Board should be involved? What really is the "oversight" function?

Realistically, anytime something goes wrong at the organization, an argument could be made that the directors failed to provide adequate oversight. It is one of those

catchall phrases that, in hindsight everybody can point to as the problem, yet is often hard to define where that line is on an ongoing basis. If you look at all the areas cited above as areas of concern, and if the Board had immersed themselves in each of those areas during the bank's existence, don't you imagine there could have been a strong argument made that the Board was micromanaging by being so heavily involved in the lending function, capital planning, etc.? But, as the Board Chair or as directors, we think it is important to understand the analysis that occurs whenever directors' activities are criticized in hindsight. In that way, directors can be better prepared to move their organizations forward.

No, we should not be involved in micromanagement, but to appropriately exercise corporate governance and oversight functions, we must also not simply rubber stamp all management decisions and directions. The oversight function requires a probing and questioning of strategies, steps, and decision points. The oversight function will require some board members to disagree with actions that are to be taken and to note their disagreements in the Minutes. The oversight function will require the Board to make specific demands of the management team, when necessary, to take certain actions, or to provide certain information to the Board, or to refrain from taking certain actions. If your community bank's Minutes do not reflect a Board that is engaged to that extent, in what we often style as a "healthy tension" with management, then consider how you could demonstrate, in hindsight, that the Board truly exercised an oversight function. It is a good lesson to keep in mind.

### ***Reconsidering Subchapter S***

Many of our clients around the country have elected to be taxed as a Subchapter S entity to provide greater tax savings, greater cash flow, and hopefully more overall economic value to stockholders. Among the myriad of tests that must be met in order for an organization to utilize that structure, is that the entity must have less than 100 stockholders (six generations in one family counting as one shareholder), must only have one class of stock, must have all stockholders who choose to remain part of the

S Corporation to affirmatively elect and consent to be taxed in such manner, typically in a Shareholders Agreement, and a few other requirements. So, electing Subchapter S status is not simply accomplished by the snap of the fingers, but we are seeing a reemergence of that structure, somewhat interestingly, as an appropriate yet conservative strategy for more shareholder value.

Consider if an organization is not located in a particularly high growth market yet, the organization historically has very strong earnings that continue to supplement capital. In order to create more shareholder value, and with an enlarging capital position through strong earnings, the organization might strategically think about pursuing growth initiatives by opening locations in new markets, pursuing an acquisition opportunity, or some other type of forward-looking strategy. However, it would probably come as no surprise to anyone that pursuing those types of aggressive strategies pose their own unique kinds of risks. Moving into unfamiliar markets or taking on the obligations of an additional entity all are perhaps much higher risk strategies to create value than simply looking internally at your organizational structure.

As a result, some of our organizations are beginning to rethink Subchapter S as an appropriate yet conservative strategy to lessening tax burden, perhaps shrinking their stockholder base so that it is more local, and thereby returning more value to individual stockholders through greater cash distributions. In the long run, that may be the much more conservative approach rather than trying to grow the bank to a certain asset size through greater acquisitions.

If your organization does not have fewer than 100 stockholder family groups, there are a number of techniques and strategies that can be employed along with the unique counting rules for stockholders (again, up to six generations of one family counts as only one stockholder), so many more organizations can take advantage of a Subchapter S structure than you might suspect. If you would like more information about how to count stockholders for Subchapter S purposes or to discuss strategies that would allow you, even with more than 100 stockholders, to restructure in a way to achieve Subchapter S status, please do not hesitate to contact us.

## **Board Chair Duties versus Presidential Duties**

In the banking world, particularly in the community banking environment, it is not unusual to have one person serve as the Board Chair and also as the President/CEO. In addition, it is not unusual to have an individual who retires from the President/CEO duties to move exclusively into a Board Chair function, or to take on the Board Chair duties if the existing Chairman retires. Recently, we had the opportunity to consult with an organization who was dealing with this type of transition within its organization and was looking for some practical advice on how the individual might separate those roles and truly move into a Board Chair role without micromanaging the new CEO. Here are some of the core suggestions we provided:

- The Board Chair role might best be thought of as being more strategic, as opposed to tactical and operational.
- The Board Chair should not be involved in day-to-day minutiae, but should set his or her sights on a higher plain, focusing on the long-term success of the organization, long-term profitability, overall strategic direction of the organization, etc.
- The day-to-day affairs need to remain within the exclusive purview of the President/CEO unless your input as the Board Chair is requested.
- Weekly or periodic recurring sit-down meetings between the Board Chair and the President/CEO are recommended. These meetings probably need to occur on a one-on-one basis even without other directors. However, these meetings are not necessarily for the Board Chair to scrutinize and review everything the President/CEO is doing, but to simply give time for the CEO to seek input and guidance from the Board Chair, if desired (especially if the Board Chair is the

former President/CEO). This kind of meeting will also allow the Board Chair to provide an outsider's perspective to the President/CEO, for the President/CEO to vocalize to the Board Chair problems, concerns or issues the President is facing, and similar dialogue.

- In a perfect world, the Board Chair might have no direct reports other than the President/CEO and all other reporting lines would go directly through the President/CEO. If that is not the structure your organization currently has, a review of your organizational chart might be appropriate.
  
- The Board Chair, of course, needs to focus on running the board meetings. As most of you know, that is a bit more task-oriented than it might seem. Creating the agenda, determining the items the other board members need to review to appropriately exercise their oversight function, and to facilitate a proper dissemination of information and discussion of items is not quite as easy as it initially seems. In addition, at board meetings, particularly for a Board Chair who previously served as the President/CEO, that Board Chair may have to get in the habit of saying, "That's a question for the President, not for me" to clearly distinguish between those vital roles of each party.
  
- It is important to ensure that the CEO has the tools necessary and is willing to make tough decisions. While this point should seem obvious, occasionally we see circumstances where, when the former President/CEO retires but remains on the Board, the new CEO may feel hesitant to make a tough decision, particularly if it is different than the decision the former CEO might have made. In these kinds of circumstances, the Board Chair, or even if the former CEO has merely become a director, must clearly distinguish the roles of being a director who is an advisor and providing oversight, and who will require (sometimes force) the CEO to make

the critical decision based on his or her best judgment, but with appropriate input. You need strong leadership who is not hesitant to make those tough decisions.

- It may be helpful to have written job descriptions for the Board Chair as well as for the President/CEO. It never hurts to delineate in writing the division of duties, or at least to have those negotiated and agreed upon in advance. Sometimes the lack of clarity is the biggest impediment to efficient operation. If anyone would like some sample job descriptions, please let us know.

### **Executive Committee versus Executive Session**

Recently, we have had the question of how to distinguish between an Executive Session and the Executive Committee raised by a few clients since the terms are admittedly somewhat confusing. So, let us outline a bit of the function of each and provide a few thoughts and pointers.

First, the Executive Committee is, in fact, a committee of the Board of Directors. It typically is comprised of a small subset of board members who are given the authority to act (primarily) on an emergency basis to make decisions for the Board of Directors when the entire Board of Directors is unable to meet collectively. In addition, the Board may assign certain specific functions to the Executive Committee to handle on its own that might not fall into the category of one of the other standing committees. For example, considering an acquisition opportunity, analyzing some unique strategies such as a stock repurchase transaction, etc.

On the other hand, an Executive Session is the term that is used to indicate that the Board of Directors will be meeting as a unit without members of the management team present. But, what do you do if certain directors are also members of management, typically like your President/CEO? In those circumstances, it is not unusual for organizations to hold two different types of Executive Sessions. The first is a session where only directors are present. Everyone who is a director, regardless of whether they are also a member of management, are present to discuss things outside of the purview of

other individuals. All non-directors are excluded. Then, it is not unusual to hold a secondary Executive Session that is simply a meeting of only the “outside” directors who hold no management position at all. So, if certain directors are excluded from the meeting, the concern often becomes what type of topics can be discussed in these Executive Sessions, what kind of decisions can be made, and what types of Minutes of the meeting should be kept? Here are a few rules to follow:

- a. The Executive Sessions should be led by the Board Chair or, if the Board Chair is also a member of the management team and the Board is meeting with only the outside directors, then a Lead Outside Director should be appointed to run those meetings. Sometimes that is a person appointed as the “Vice Chair.”
- b. In any board meeting where some of the board members are excluded (an Executive Session with only outside directors) no formal decisions of the Board of Directors should be made. The outside board members do not have the right to exclude management members who are directors from the meeting and then make board decisions without having those management members who are directors vote on it (unless of course there is some type of conflict). So, most Executive Sessions, and all outside director-only Executive Sessions, are generally informational and information-sharing and open discussion sessions, not truly meetings where core decisions are made.
- c. Minutes should be kept of the Executive Session to document that they happen. However, those Minutes should not be anywhere near as detailed as open board meeting Minutes. Again, keep in mind that no core decisions will be made. So, we typically recommend “topical” Minutes that merely outline that the Executive Session was held, and include a list of the topics that were discussed, and maybe some brief explanation. Again, since no decisions are to be made, there will not

be any recording of who made motions, who seconded a motion, what the decision was, etc.

- d. Executive Sessions are not intended to be secret sessions. Everyone should know they are happening and they should occur on a fairly frequent basis. If you do not hold them monthly, then at least quarterly Executive Sessions would be appropriate. Because the sessions are not secret, whoever is running the meeting should, thereafter, report the findings to the President/CEO or simply provide the topics that were discussed to key management members.
- e. Keep in mind that for public companies, the use of a true Executive Session with only outside directors is mandated. Therefore, it certainly becomes a best practice that has some level of expectation even for private companies. For public companies this is mandated on some type of recurring periodic basis which we typically interpret as at least quarterly. Private companies might want to follow that same guideline.

### *Meeting Adjourned*

We hope this month's edition has provided you some insight into oversight! We hope you will take some of this information as best practices and we trust that your Boards continue to strive to achieve your organizational mission, provide appropriate oversight and promote greater shareholder value. If we can ever provide Board training for you or strategic planning to address these kinds of issues, please let us know.

As we occasionally do, we also wanted to make you aware of an upcoming workshop we will be hosting. On May 4<sup>th</sup> and 5<sup>th</sup> we will be hosting our annual Community Bank M&A Workshop. This is done with the sponsorship and in conjunction with the ICBA, and this year the event will be held virtually. This will be two half-day sessions (and an opportunity for private consultations, to address the evolving merger and acquisition arena from the perspective of buyers (discussing best

practices), sellers (appropriate techniques if you are on that side of the aisle), and banks trying to remain independent (fending off often unwelcome acquisition offers or positioning your bank to thrive when others are selling. For more information or to register, you may following this link: [ICBA Mergers & Acquisitions Workshop](#).

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](http://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](mailto:psmith@gerrish.com).