



THE

Board Chair Forum

Opening the door to new ideas

NEWSLETTER

Gerrish Smith Tuck, Consultants and Attorneys

September 2021

In this month's edition of *The Board Chair Forum Newsletter*, we question initially whether the Board Chair should take on a new role. Perhaps interestingly, that role might be to help the organization pursue relevancy as well as stockholder value. We also somewhat question why Boards of Directors, or maybe even the Board Chair, are often hesitant to enter into employment or similar contracts with management. We take the position that if a contract is structured appropriately, it should benefit all sides and therefore is a benefit not a detriment to the organization. Finally, we have had a number of clients recently inquiring about the bank holding company structure. We take this opportunity to revisit the bank holding company structure.

We are happy that the cooler weather is beginning to set in in many parts of the country and we hope you find valuable information in this month's newsletter.

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*

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.

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Board Chair's Summary

- ◆ Your New Role: Relevancy Czar
- ◆ Why So Much Concern Over Contracts?
- ◆ Revisiting the Bank Holding Company Structure

Your New Role: Relevancy Czar

If you've had the opportunity to hear us speaking anywhere around the country in the past few months or perhaps in your own strategic planning session where we have been, you've heard us touting what we foresee as a new emerging world for the Board Chair. To give it a fancy term, we would call it the "Relevancy Czar". Interestingly, of all the various facets of the role of Directors and the Board Chair, including what we have preached for over the past 30 years of ensuring that the organization is enhancing shareholder value, do you perhaps now in the current environment see the role of the Board Chair as well as the individual Board members as doing everything necessary to promote the organization's relevancy? We would suggest that you should see that as part of your role even though, as an emerging role, it may seem difficult to pinpoint what you are to do.

Let's consider technology. Under no circumstances would we ever suggest that Board members or the Board Chair are required to become the technology experts at the bank. That's what you've hired those millennials for, right? But that doesn't mean that Directors and the Board Chair do not have a role in promoting the strategies that are

desired related to technology. For example, do you merely intend for your bank to try to adopt technologies after the larger banks have already figured it out? Do you want your organization to be positioned as a “fast follower”? Do you want your organization to be on the leading edge of technology information (if not actual implementation of technology) so that you are able to see emerging trends and direct how the bank responds to technology? We think technology is the most obvious area where you can see whether an organization is maintaining its relevance but there are plenty of other areas as well.

Consider whether your organization is relevant in terms of its organizational structure, its product and service offerings, the branch network (for example, too many branches or not enough branches) relevant in terms of attracting and retaining the best employees through the right types of compensation and a host of other factors. The area of dealing with our employees and relevance is perhaps going to be the most difficult. Some organizations are allowing employees to continue to work remotely while others are mandating that employees come back to the office. In one scenario we encountered employees who were frustrated at having to return to the office under the theory that if they were required to come back to the office it must indicate that they did a poor job working remotely. Do we need to allow more worktime flexibility and work from home scenarios (even after COVID passes) in order to stay relevant? We think Boards need to make an honest assessment of their ability to not only stay relevant but continue to promote relevancy throughout the organization. So, supplement your thinking on the Board’s job and the Board Chair’s job related to enhancing shareholder value as necessitating the focus on organizational relevancy both now and in the future.

Why So Much Concern Over Contracts?

Over the years we have often encountered quite a bit of concern over contracts, particularly as it relates to the Board authorizing employment contracts or change in control contracts or just about any other type of contract for the management team. Most of the time we find that when the Board has hesitancy over the implementation of new

contracts that it is because the Directors in their individual capacity or through their businesses have at some point been “burned” through a bad contractual relationship. Maybe you could blame it on the fact that we are lawyers but of course, we love contracts because of the general certainty it provides in situations, the predictability that goes with it and, if structured properly, the benefit it provides to both sides.

Take for example an employment contract for your Chief Executive Officer. The contract should not make it more difficult to terminate the employee if there are valid reasons for termination but gives both sides some relative protection. For example, if a majority of the Board of Directors wants to simply vote to remove the CEO from her position, they should be able to do so. However, if that removal is without cause, then it seems the executive should be entitled to some type of cash payment. Both sides have appropriate protection. Likewise, if your CEO is doing something that is a reasonable ground for his termination, the Board should be able to execute that termination without having to be on the hook for the payout of thousands of dollars.

Also give consideration to change in control agreements. In the current M&A environment these are certainly much more prevalent and often times even expected by purchasers. But, should a potential selling organization hesitate to enter into the contracts under the belief that it might prevent a deal from going through? In most cases that never happens. The buyer might very well factor in the cost of contractual payouts in arriving at a price, but they do that for your core vendor contract, the lease on your building, and all other types of contracts as well. So, in appropriate circumstances it might be best to “lock up” your key management with change in control contracts, but the contracts should be structured so that they benefit all sides, as described above. With a change in control contract, if an organization engages in a sale, merger of equals or any other change in control and the purchasing entity wants to retain the executive, then typically the executive is not entitled to a windfall cash payment. But if a change in control occurs and the executive loses his or her job or has a material downgrade in position or responsibilities, then the executive can trigger a cash payment and terminate their relationship with the employer. So, again, both sides are protected. But, as an additional

protection for the purchasing entity, the contract might provide that when the employee receives a lump sum cash payout (in the nature of a golden parachute or otherwise) then the executive is also subject to certain non-compete restrictions in terms of geography, a certain period of time or other factors.

A third category of contracts we often see particularly in the current Merger & Acquisition environment, are what are typically referred to as “stay” bonuses or “retention” bonuses. This often occurs when an organization knows it is going to position itself to sell, but they are concerned that key employees might leave once a transaction becomes public, and that might hurt the franchise value of the entity that is being sold or a buyer might even hesitate to complete the transaction if the key members of management are going to leave and go somewhere else. So, what is the solution? In its simplest terms, a bribe. By that we mean that a stay or retention bonus can be implemented so that if an individual works collectively with both the potential purchaser and the current employer to help facilitate a transaction, and agrees to stay with the new employer for some period of time (normally only six months or a year or so) then the executive or employee would be entitled to a lump sum cash payment at the end of that term. Again, those can be very helpful in an acquisition context to preserve the value of what is being acquired.

The key point in all of these circumstances is that a properly structured contract should provide some mutual benefits to all parties, not be one sided and therefore not be viewed negatively by the parties. If we can help you or your organization in setting up appropriate structures for your employees or executive team, please let us know.

Revisiting the Bank Holding Company Structure

We believe community banks of all sizes can benefit by being in a bank holding company structure. Recently we’ve had a number of opportunities in different places around the country to help banks that are not in a bank holding company structure give consider to implementing that strategy. So, if you are currently not in a bank holding company structure you might find this interesting. For those of you who are in a holding

company structure, we thought you might find the revisitation of the benefits of a holding company important to remember how best to utilize the structure for shareholder value as well as relevancy.

We believe organizations of all sizes can benefit by being in a bank holding company structure. For those of you already in a bank holding company structure, we believe it ought to be used as a value-enhancement technique. Often, the first questions asked are what is a bank holding company and why is it important? As many of you know, a bank holding company is simply a corporate entity that owns the bank, but why would we want to put a corporate entity between our financial institution and our stockholders? A primary reason is that corporate entities can more easily do things than banks, by their nature, can. Take, for example, repurchasing stock. A bank can certainly repurchase its own shares, but it requires regulatory approval and stockholder approval, and an amendment to your organizational documents to reduce stated capital. Therefore, if a bank stockholder desires liquidity, it may be an inefficient process to go through. On the other hand, if an organization has a bank holding company, that organization can provide instant liquidity to stockholders in most cases and repurchase shares on short notice without regulatory or stockholder approval. The bank holding company structure also is generally helpful when looking at the acquisition of other organizations as a way to have multiple structures available for the purchase by merging bank charters together, keeping it separate under a holding company structure and other possible beneficial techniques.

Equally important is the fact that in a capital needs situation, an organization in a bank holding company structure can utilize the corporate entity to borrow funds from a third party and simply contribute the cash to the bank to increase capital ratios. For those of you with less than \$3 billion in total assets, the technique is very beneficial because capital ratios are not consolidated between the bank and holding company. While the holding company structure will require the Federal Reserve as a regulator for the institution, if the entity is merely a shell entity owning the bank stock, then the examination can often be done off-site and is very non-invasive. Consider a bank

holding company if you are not in that structure and, if you have the structure, consider using it to create liquidity for stockholders through stock repurchase transactions, using it for capital planning purposes, considering it in your acquisition structure and for other important uses.

If your Board is considering the implementation of a bank holding company and you would like more detailed information on how to structure it, costs and other factors, please reach out to us and we can provide you additional information.

Meeting Adjourned

Fall is officially here along with football season which is great news but it also seems to make the calendar days fly by quicker and soon we will be at the end of the year. So, we hope you find the techniques and topics outlined in this month's newsletter informative to promote shareholder value as well as relevance. We have a lot of Fall planning sessions on the agenda so we will look forward to seeing many of you in the coming months and in the meantime if we can be of assistance to the rest of you, please let us know.

Until next time,



Jeffrey C. Gerrish



Philip K. Smith



Greyson E. Tuck

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700 Colonial Road, Suite 200
Memphis, TN 38117
Phone (901) 767-0900
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