THE

Board Chair Forum

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys
June 2024

In *The Board Chair Forum Newsletter*, we are always looking at the role of the Board Chair and how that role can be enhanced for financial institutions, as well as looking at key topics the Board Chair may want to discuss with the Board, or topics that all board members might want to become more informed about to improve the organization. In this month's edition of *The Board Chair Forum Newsletter*, we begin by focusing on organizational relevance and trying to identify what that really means. We will also discuss a few issues we have seen with clients recently as they look toward the fall for strategic planning sessions, as they look at their organizational structure, and we also look at some emerging issues from a regulatory standpoint.

As we evaluate each of these issues, keep in mind that no two Boards are identical, and your Board, itself, should evolve probably from year to year, or even from meeting to meeting in terms of the areas where you focus, the emerging issues that are discussed, and the manner in which you conduct your business. We hope this newsletter provides some insights on those and other areas.

Happy Reading!

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Board Chair's Summary

- ***Is Your Organization Relevant?***
- ***All Banks Need a Bank Holding Company***
- ***You Don't Have to Make Dramatic Decisions at Every Planning Session***
- ***Update on Regulatory Matters***

Is Your Organization Relevant?

As our firm has begun to articulate in the multiple presentations we do across the country, one of the traditional key focuses for the Board of Directors needs to undergo a bit of a shift. In particular, we believe the Board's overarching obligations should slightly shift from an absolute singular focus on shareholder value to a more comprehensive (and perhaps more daunting) focus on stakeholder value. The key constituents that make up your stakeholders begin primarily with stockholders and stockholder value. However, the point is that in the current environment, we are supplementing a focus on shareholder value by also focusing on value to your customers, value to your communities, and value to your employees. The focus should be to ensure that we are creating value for each of these stakeholders.

Next, as we often explain, if your organization is providing value in each of those areas, then the organization is well-positioned to be able to maintain its independence well into the future, provided it is also doing one other critical thing that was not so much of a concern in the past. That focus is on maintaining organizational relevance. In essence, stakeholder value plus relevance equals independence. So, that should lead the Board of Directors to strategically focus on addressing the question: Is my organization maintaining relevance? We suspect that for many Boards of Directors that question cannot fully be answered unless an additional question is asked: How do you know if you are maintaining relevance in each of those areas? We have tried to set out some "tests" that will help you know if you are doing the appropriate things to maintain relevance. Some of these are intended to be a little humorous, but we hope it makes the point. In essence, you might not be maintaining relevance if:

- Your bank still provides telephone banking, but does not have online account opening,
- None of the markets in which you are located are experiencing any actual growth,
- You are building more branches, but you have not yet eliminated Saturday lobby hours,
- You still have a fax machine, but no electronic signature products,
- You do not allow flexible work schedules or remote workers, but you do require ties,
- You allow casual Friday, but you do not provide standing desks,
- All of your directors were born before the first mobile phone was introduced (1973),
- You offer unhealthy food and snacks to directors, but you have no director succession plan.

There are probably hundreds of other examples we could give, and you might even come up with a few funny ones on your own. If you do, please feel free to send them to us. But, if any of these hit close to home for your organization, it might be time to engage in some serious discussions about the relevance of your organization. The question is not whether you feel relevant today, it's whether you think you will be relevant in five years, and if not, what do you need to do from a shareholder, customer, community and employee standpoint to maintain relevance.

All Banks Need a Bank Holding Company

Over the years we have helped scores of banks reorganize into a bank holding company structure. In fact, about 85% of all financial institutions in the country are in a bank holding company structure. It is certainly something we recommend because of the benefits it provides. However, there are still banks that have not yet taken that step, and this year we are actually helping a few of those finally make the transition to creating a bank holding company. For those of you that already have a bank holding company, it is important to understand (or maybe to remember) why you formed the holding company in the first place, and some of those benefits that it can provide, to ensure that you are using your structure in the best possible way. So, whether you are thinking about forming a holding company or have one already, we thought it would be helpful to briefly cover some of the key benefits of the structure. Those are set forth below.

Organizational Efficiency

The overriding benefit is that by having a corporate entity own your bank, shareholder rights, and how the organization conducts its business are governed by the Corporate Code rather than the Banking Code. In most states, that creates much better organizational efficiency and structure. For example, it often helps you remain independent by providing better anti-takeover mechanisms. It often helps you streamline the process for your board meetings and shareholder meetings by providing a more modern approach to notices of meetings, voting by proxy, and shareholder votes.

Capital Planning

The holding company structure also helps with capital planning. Without a bank holding company, a financial institution trying to raise capital really has only one option, which is sell more stock. While that may be appropriate, it often results in dilution to the existing stockholders. With a bank holding company, the corporate entity can borrow money from a third party (a correspondent bank, a wealthy director, etc.) and the cash the holding company receives can simply be "downstreamed" into the bank as Tier 1 capital. So, particularly when interest rates are lower and cash is pretty cheap, capital planning does not have to involve selling more shares of stock and creating dilution for existing stockholders. Rather, debt financing can be effectively and efficiently utilized.

Creating Liquidity

Creating liquidity for stockholders is substantially easier in a bank holding company structure as well. Without a bank holding company, if a bank wants to repurchase shares from an existing stockholder, doing so might typically result in a reduction in the bank's stated capital, which might require shareholder approval of an amendment to the Articles of Incorporation or Association of the bank, and may also require regulatory approval. In a bank holding company structure, the holding company (with certain limited exceptions) can simply repurchase the shares from stockholders at any time on a negotiated basis, and can do so often without any type of additional shareholder approval or regulatory approval being required. So, it is an avenue for instant liquidity for a stockholder that needs cash.

Mergers and Acquisitions

In a merger and acquisition context, the holding company certainly provides benefits for structuring different types of transactions as well. With a bank holding company structure, your organization might target another organization, but desire to leave the charter of the target organization in place and simply have it owned by the holding company that would then own two subsidiary banks. That might be appropriate if the organization is located in an entirely different market, has some goodwill associated with its current Board, charter, and bank name, etc. Without a bank holding company, you are pretty much limited to simply merging the target bank charter out of existence.

There are plenty of other benefits we could point to in a bank holding company structure, and, therefore, it is not a structure your shareholders should fear. Our experience, historically, has been that any time a holding company structure is opposed by a group of shareholders, it is primarily because they simply do not understand the process, they somehow feel their rights as a shareholder will in some way be diminished, or they simply do not like change. Our recommendation is that if you do not have a holding company, form one. If you have an existing holding company, use it for the benefits that it provides, including those listed above and others. It is a tool that certainly creates better stakeholder value. Let us know if you have questions.

You Don't Have to Make Dramatic Decisions at Every Planning Session

2024 has already been an active year for strategic planning in the spring season. We have a few planning sessions scattered around in the summer, and then as we look to the fall, our calendars are extremely busy with strategic planning sessions all across the country. There is one interesting dynamic of strategic planning that often comes into play from some of our clients who like to do yearly strategic planning (and in fact we recommend yearly strategic planning). The concern often arises about whether the organization should hold a strategic planning session if there are not major decisions to be made. Keep in mind, strategic planning does not have to be a session where you are totally changing course or making some type of dramatic change or decision. Interestingly, a strategic planning session in our opinion, ought to be utilized to challenge the status quo of what you are doing, not so much for the idea of suggesting you have to change, but to allow a Board and the executive management team to scrutinize what they are currently doing. We often find when doing so, a well run organization will perhaps even come back to the conclusion that what they are doing is correct, there is no need to change course, and the organization is comfortable that after reevaluating existing strategies in light of current conditions, the organization is, in fact, well positioned and on the right path.

Thinking about this, consider this phrase we have utilized with a number of clients where they somehow felt that their strategic planning needed to result in major changes or decisions. The comment that we provided was this: "contentment does not equal complacency." Think about that for a moment and see if it applies to your organization. You can be content with where you are, you can be content with the bank's performance, you can be content with all of the metrics that your organization is producing in terms of return on assets, return on equity, efficiency ratio, dividend payments, etc. However, that contentment with what you are doing does not automatically mean you are being complacent. On the contrary, you are still focusing on maintaining organizational relevance, you are still looking at new markets, you are still looking for new opportunities, you are still strategically planning for things that could change and impact the organization. As you think about your future strategic planning, remember that when things are going well, it may be the right strategy to be content, but contentment does not mean complacency.

Update on Regulatory Matters

As we have highlighted in most of our newsletters recently, it seems we are continuing to get an increasing number of calls from clients across the country who are either anticipating a problem exam, have had a problem exam, or are otherwise being scrutinized or penalized by the regulators in some form or fashion. A word of caution generally is that it probably will not surprise you that when the regulatory environment tends to become more difficult, it seems there are more and more advisors willing to help. This is a little bit akin to the way in which plaintiffs' lawyers can often be referred to as "ambulance chasers." So, be mindful of the regulatory "storm chasers" who are keeping an eye on the listing of enforcement actions and trying to chase down business as a result of it. If you need assistance, make sure you have someone who deals with regulators and regulatory issues constantly, not just when times are bad.

We have also noted recently a headline indicating that, *The Supreme Court May Soon Defang Bank Regulators*. In this particular situation, it appears the Supreme Court is examining whether courts and judges must give deference to regulators in interpreting laws passed by Congress, and at the forefront deals with the Consumer Financial Protection Bureau, but it could be any regulator. We see this coming up more and more these days from the frontline examiners. For example, where does the authority come from for a field examiner to make an allegation against a bank that it is violating the Fair Housing Act and committing housing discrimination? If the regulator thinks it looks like the bank possibly could be engaging in some type of discrimination, it appears the burden shifts to the bank to prove that it is not discriminating. But no matter the facts that the bank puts forward, if the regulator still thinks the bank's actions look questionable, they can make a referral to the Department of Housing and Urban Development and the Department of Justice. If that happens, you are then up to your neck in bureaucrats merely based on some field examiner or supervisor's interpretation of a highly complex statutory provision passed by Congress. If you were to challenge that finding, do the courts have to give deference to that determination? Historically, the answer is "yes" and historically the deference was provided unless there was a determination that the regulator was "arbitrary and capricious." Note that there did not have to be a finding that the regulator was correct – just that they had a reasonable basis for what they were doing (therefore, not arbitrary and capricious).

It is our belief that if the Supreme Court begins to take up some of these "deference" cases, it may be beneficial in reshaping the landscape of how the regulators view their jobs and the deference that courts do or do not have to give them. We will keep an eye on that and report back more in future editions.

Meeting Adjourned

As we move into the summer months, as we stated, many of you are beginning to prepare for the fall planning session. It is not too early to begin to do that and to get your plans updated, and to look for strategic opportunities when others may simply be trying to tread water. The end of the summer will also begin the season of a lot of state banking association conventions as well, and we encourage each of you to attend those and to send your Board and management when you are able. We look forward to seeing many of you at those events.

Please let us know anytime we can be of assistance.

Until next time,

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