The
Board Chair Forum

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys
November 2024

This is your pre-Thanksgiving and post-election edition of the Board Chair Forum Newsletter! Yes, the Presidential election has concluded and it was actually a stunner! By that, we mean we are stunned that apparently all (or most) of the votes have already been counted!

In this month's edition of the Board Chair Forum Newsletter, we address Board governance from the position of engagement, education and evaluation. We also confront the issue of what to do about credit unions in an M&A context. In addition to supporting the efforts to curb those types of transactions, we also pose an alternative line of thinking for those of you who may find yourself in a competitive bid situation. Here is a crazy idea – why don't banks just start paying more? We address that and the reasons why banks are sometimes hesitant to bid higher. We also reflect on strategic planning in successive years for an organization, and look at Boards which choose a short-term strategy of doing nothing, or alternatively, being extremely patient, and how that is often a very good approach. You do not have to have something new and different every year.

We also want to remind everyone about The Board Chair Forum that we hold every year in January. You will find more information about that in this month's newsletter as well.

We hope your Fall is going well and as the end of the year starts rushing at us, we hope you continue to stay diligent in your efforts and we hope this newsletter is a good resource for you.

Happy Reading!

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Board Chair's Summary

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The Board E's

Recently, a Board Chair described to us his approach toward managing his Board of Directors and how he strives to improve overall corporate governance for the organization by focusing on "the three E's." By this, he meant that they ask directors to focus on Board Engagement, Education and Evaluation. In terms of Engagement, it was indicated that directors (and director candidates) must show a willingness and capacity to be fully engaged as a board member. That means being prepared for meetings, having the time to review all of the materials, and to fully participate in the board meetings and ask questions. As the Chairman described it, there is an expectation that every director will ask questions at every board meeting. If directors are not asking questions, then, in the Chairman's view, either the board members are not prepared, or he as Chairman is not doing enough to create interest and introduce new topics in order to elicit the questions. We agree that Engagement is a key function of community bank board service.

Secondly, Education is at the forefront of this Board's corporate governance. They create a specific expectation that directors, at a minimum, should have at least 10 hours of specific education a year. Occasionally, the Board will invite a speaker to the board meeting which will provide some of the required time for education. In the case of the planning session we facilitated, it was recognized that each director would receive two hours of credit given that we spent some time focusing on the state of the industry and the Board's duties in certain circumstances, etc. The organization helps the Board achieve their education hours by providing information related to national and state conferences, helping directors become aware of online webinars that are available to be attended at the director's discretion, and even paying for the directors' subscriptions to certain trade publications that are an educational tool. One director asked if his subscription to the Wall Street Journal would qualify, to which the group rousingly agreed "No, it was not, because those guys don't know anything about community banks!" So feel free to make your own expectations as permissive or as restrictive as you would like, but the key is to ensure directors are fully educated.

The final E component is Evaluation. How does the organization determine which directors will be subject to reelection? Naturally, the answer for most community banks is we simply reappoint ourselves every year. But, with a growing and more dynamic Board, there should be some aspect of periodic evaluation. This particular Board has three-year terms for directors and prior to being re-nominated, each director would complete a personal evaluation form with respect to the ability of the board member to meet the Bank-maintained list of director expectations (like the education requirement above along with attendance and community participation expectations). Simply stated, directors are evaluated against the ability to meet those expectations. This points out the need for a formal Nominating Committee and for the Board Chair to sit down with each director when they are subject to reelection and conduct the brief evaluation.

While this kind of structure might not work for every organization, it is a good simple format to think about the three E's of directorship and consider implementing some aspect of that for your own organization. If we can help, let us know.

The Community Banking Board Chair Forum

As many of you know, this newsletter was an outgrowth of the Board Chair Forum Conference we began hosting around the country many years ago. More recently, the Conference has settled on a yearly event in Florida, normally early in January, and in 2025, we will continue that format on January 9th and 10th at the JW Marriott Marco Island Beach Resort in Marco Island, Florida. We only have a few spots left so if you are planning to attend, you should go ahead and sign up. We have included a link that follows this article where you may do so. In particular, keep in mind that this is a gathering of Board Chairs, other board members, and even executive management from around the country for the purpose of a facilitated open forum discussion of the key items impacting organizations just like yours. It is a bit of a scripted/unscripted open dialogue and many attendees indicate that they gain as much from this event as any other because they get to hear directly from people in their same position in different parts of the country, rather than simply having the moderators or presenters running through a list of pre-prepared topics. We find it a great way to kick off your year and we would welcome your attendance. This event is hosted in conjunction with the Barret School of Banking. If we can answer further questions about it, please let us know, or please see the following link to register: 2025 Community Banking Board Chair Forum

What To Do About Credit Unions?

As many of you know, 2024 has already been a record year in terms of the number of announced proposed deals of credit unions acquiring banks. So, what are we as an industry to do about that if we view it as a bad thing? The concern often involves the fact that credit unions and banks are supposed to be different animals. That is most notably pointed out by the fact that credit unions are not subject to CRA and do not pay taxes. However, in order to achieve those "benefits," credit unions are supposed to be held to a different standard, with limitations on the types of lending they do, and most importantly, a limitation on who can actually be a member of a credit union. You may be familiar with the terms of art that a credit union is limited to only serving those individuals within its "field of membership." Further, to arrive at a field of membership, the members must share a "common bond." Interestingly, you will never hear those terms discussed when reading an article about a credit union acquiring a bank. So, are these credit union acquisitions of banks a bad thing, and should the community banking industry try to put a stop to it?

There are numerous legislative efforts, both at the state level as well as nationally, that have either been put in place or are being considered in order to level the playing field since the result of a tax-exempt credit union buying a bank is that the combined organization still remains exempt from taxation. We support those efforts, recognizing the competitive advantage that credit unions have in a competitive bid process because of the lower taxation they experience, the beneficial accounting treatment credit unions receive on goodwill created in a transaction, and the idea that credit unions may merely focus on creating "organizational value" rather than "shareholder value" when analyzing a potential deal. The result is that the credit union bids are often substantially higher than bank bids when a bank markets itself for sale. So, while we support the efforts to curb that type of activity, we also have been discussing nationally that part of the way to slow the tide of credit union acquisitions of banks is, when there is a competitive bid situation, for the competing banks to simply pay more.

When our firm runs a financial model for a client looking to acquire another bank, we generally assume that other competing banks and their financial, legal, or investment banking advisors have models that are generally the same. In fact, when scrutinizing a transaction, most banks default to the same metrics to determine whether a particular pricing level for the transaction is appropriate. For example, you might typically hear that a transaction needs to show earnings per share accretion of at least 7% to 10% within the first year or two following its completion. Likewise, you might often hear that because book value per share will be diluted for the purchaser following a transaction (assuming the buyer pays more than the target's book value as the acquisition price), that the repayment timeframe to recoup the dilution to book value should be no more than three to four years. But, where do those metrics come from? Why couldn't we do a deal and pay a little bit more, but have a book value repayment period of five plus years? The answer is that those metrics are those that public companies utilize when scrutinizing transactions. However, if you are a private company looking to bid on a bank and your goal is long-term independence, you might not worry that your book value dilution repayment timeframe is more than three years. You would not have to be concerned that with a longer book value dilution repayment timeframe, your publicly traded stock is going to be negatively impacted on a publicly traded market by making that announcement. A lower earnings per share accretion in the first years and a longer repayment term on book value dilution might still be acceptable in order to be competitive in the bid process and eliminate credit union competition.

All of that is a fancy way of saying that most community banks can afford to pay more when they are bidding on a target bank, but they simply choose not to do so based on a set of metrics that may no longer work in a more competitive environment for transactions. So, if you are looking at buying another organization and credit unions are likely to be an interested bidding party, you may want to consider pricing the deal more aggressively in a fashion that still creates value to your shareholders, but throws some of the old metrics out the window.

Board Fiduciary Duties

If anyone is concerned about credit union acquisitions of banks as described above and would like more information about the fiduciary obligations of board members when considering any potential transaction that might involve a credit union, we would be happy to send you a copy of a memorandum our firm prepared for multiple state associations that helps a Board understand that merely because a credit union offers to pay $1.00 more than a bank does not mean the Board has a fiduciary obligation to sell to the highest bidder. If you would like to see that memo, please email us at psmith@gerrish.com and we will get it to you.

Patience as a Strategy

As most *Forum* readers know, our firm facilitates scores of planning sessions for banks of all different sizes in all parts of the country each year, and 2024 has certainly been a busy year in that regard. What is often interesting to us, is to be able follow up with a bank with planning sessions in multiple years, and to look back at previous decisions and strategies, and compare them to current operations to determine if the strategies are working the way they should, should there be a modification of the strategies, or do we need to try something totally different.

In some of our recent meetings where we have had the opportunity to conduct planning for clients in successive years, we noted that a year ago as banks were looking forward to 2024 and thinking about what all it might entail, that some of those organizations were taking an approach that their primary strategy was merely "survive 'til 2025." As a result of that posture, the key strategy, if it were boiled down to one word, would have been "patience." The idea was that, rather than the Board and Executive Management panicking and feeling like, with regulatory pressures, AOCI, and a presidential election happening in 2024, that the bank needed to begin making massive changes and preparing for some type of material change in circumstances. Rather, many community banks that we dealt with, simply decided that the plan for 2024 would be to somewhat "stay the course," not panic, make marginal improvements where they could, but not try a wholesale different strategy. The belief was that time could fix some of the problems (like AOCI for example), that interest rates would somewhat moderate, and the organization would be in a better position. We are happy to report that the patience strategy did, in fact, pay off for many organizations who found that maybe while their overall performance metrics were not substantially improved, they were generally better overall. So, sometimes choosing to do nothing is its own strategy; sometimes choosing to be patient and let circumstances evolve, is also a valid strategy. What is your outlook for 2025? If you have survived until 2025, what's on the horizon next?

Meeting Adjourned

So, we apparently have a President-elect and he is even beginning to nominate cabinet members, so things are moving fast. We here at GST would like to point out that we went on the record of absolutely predicting that either the Republican candidate or the Democrat candidate would likely win, so once again, we have been accurate this year! Since we are in the business of making accurate predictions, we would now like to go on the record and say that we think the future President will put in place some new policies, keep some old policies, will make some people happy, will make other people angry, but that we will all generally be okay, we'll adapt to the circumstances, and we'll live to tell the story in four years when this all rolls around again!

Until next time,

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