
GERRISH'S MUSINGS

Jeffrey C. Gerrish
Philip K. Smith
Greyson E. Tuck
Gerrish Smith Tuck
Attorneys/Consultants
700 Colonial Road, Suite 200, Memphis, TN 38117

Phone: (901) 767-0900 ♦

♦ Email: jgerrish@gerrish.com ♦ psmith@gerrish.com ♦ gtuck@gerrish.com ♦

Website: www.gerrish.com

May 30, 2025, Volume 538

Dear Subscriber:

Greetings from Illinois, Indiana, Montana, Minnesota, Iowa, Arizona, West Virginia, Ohio, Nevada, and Tennessee!

A WARNING ON BANANA PEELS

We recently facilitated a strategic planning session where a common theme permeated throughout the discussion. That theme was the importance of watching out for banana peels. If you are wondering what the banana peels are, they are those items that can trip you up and cause you to fall flat on your back. Put another way, they are things that might produce material, unintended negative consequences for the bank.

The group discussed banana peels that are associated with a number of different business considerations. In this planning session, it was the (somewhat jokingly) way of pointing out the risks associated with certain decisions. The banana peels discussed during the planning session ranged from credit risks to an unexpected loss of a key employee to having too much debt at the holding company level.

The reference to banana peels throughout the strategic planning session was somewhat humorous. The underlying importance was not. We actually thought it was a pretty good way to keep in mind that a major component of strategic planning is risk identification and mitigation.

This document has been prepared by Gerrish Smith Tuck, PC and Gerrish Smith Tuck Consultants, LLC ("Gerrish Smith Tuck") for informational purposes only and is not, and should not be construed as, legal, accounting, tax or other professional advice on any subject matter. This document and the information presented herein do not create an attorney-client relationship and are not a solicitation to offer legal advice. Any responses to any question regarding the information contained in this newsletter will not create an attorney-client relationship, and whatever information is disclosed will not be privileged or confidential unless Gerrish Smith Tuck has agreed to act as legal counsel and a written engagement letter with Gerrish Smith Tuck has been executed.

To protect the exclusive rights and privileges the author or others may have pursuant to applicable intellectual property or other laws, any use of this publication to "train" generative artificial intelligence (AI) technologies to generate text is expressly prohibited. The author and other third parties with such rights and protections reserve all rights to license use of this work for generative training and development of machine language models, or any similar application.

Watch out for the banana peels out there. If your community bank does not avoid them, the results can be unpleasant and long lasting.

EXECUTIVE COMPENSATION

We were recently visiting with a group of senior executives. Some of these executives were lenders, many of whom were making more money than the CEO – for a variety of reasons, but primarily due to incentives. The conversation turned toward regulatory issues. We were asked whether the regulators would ever take the position that executive compensation is or can be excessive.

The regulators' primary tool to attack executive compensation in a non-problem bank situation is to declare it "unsafe or unsound." This is on basically a "shock the conscience" compensation test or a system that produces shock the conscience compensation. The regulators do have certain guidelines on compensation, which they can try and tie it into, but the reality is their normal approach is that the compensation is unsafe or unsound for the bank. Keep in mind that unsafe and unsound compensation is in the eyes of the "not highly paid" bank examiner and may be different than unsafe and unsound in the eyes of a seasoned highly paid bank executive. Certainly different perspectives based on different pay grades and levels.

Over the years, we have only run into a couple of attacks in non-problems banks on compensation issues. Our advice is don't lose sleep over it.

DIRECTOR NOMINATIONS

Many community bank holding companies have recently held their annual meetings. For most, the meeting is typically uneventful. However, every now and then, a company sees a curveball that they were not expecting. That can come in a number of different forms. Sometimes it is the result of an unexpected director nomination.

Typically, at community bank holding company annual meetings, the existing directors and maybe one or two new board members are nominated to serve as board members for the upcoming year. Every now and then something different happens, and a shareholder has an individual they want to nominate to the board. If that shareholder wants to make a nomination, how do they properly make that nomination? The answer: It depends.

Many holding companies do not have any specific director nomination process in their Articles or Bylaws. These holding companies are somewhat exposed at an annual meeting because

a lack of a specific process is really the same as saying any process goes. For these holding companies, if a shareholder shows up and nominates an individual and has enough votes to get them elected, it is often very difficult to keep them off the board.

Other holding companies have a specific director nomination process in their Articles or Bylaws. For these holding companies, a shareholder is required to follow a specific process in order to properly nominate an individual for election to the board. That process typically requires prior written notice of the nomination at some specific time before the meeting, which written notice must contain specific information about the nominated individual, their experience, share ownership, and the like.

If your holding company has not done so, you might want to take a look at your Articles and Bylaws to see if the holding company has a specific director nomination process. If it does, make sure it is followed to the T for nominations that may come up during a meeting. If the holding company does not, the board may want to consider adding appropriate amendments to the holding company Articles and Bylaws. This is one of those circumstances where it really will not be an issue until it is. At that point, you will probably wish you had some type of specific process.

REMAINING INDEPENDENT

As most *Musings* readers know, we are strongly in favor of independent community banks. We also advocate that remaining independent as a strategy cannot be done passively. It requires affirmative action. Often in strategic planning sessions the board will discuss the issue of independence. More often than not, the long-term strategy enunciated is “to remain independent subject to the receipt of an unsolicited offer, in which case the board will appropriately exercise its fiduciary duty on behalf of all shareholders.” Notwithstanding the overall bank and holding company strategy of remaining independent, the second question regarding independence involves whether any of the individual large shareholders (directors or otherwise) will want or need to sell their shares in the future. We have often been in meetings where the long-term strategy is to remain independent, yet one of the directors who may be a significant shareholder indicates that he or she wants the bank to remain independent but will need to sell some or all of his or her shares.

In connection with situations like this, we have a four letter word we like to use, which is “PLAN.” If there needs to be a redemption of shares or a placement of those shares elsewhere, then the group needs to plan as to how that would be accomplished to satisfy all the participants.

As it relates to the sale of shares, we encourage boards to have candid discussions with respect to the ownership of their individual shares.

BEWARE THE ESTIMATE

We have recently been assisting one of our community bank clients in changing their core processor. As part of the process, they requested that their current core service provider give them an estimate for the expense related to the deconversion process. If you are not familiar, this basically represents what the current core provider charges to assist in converting the data from the current processor software to the new processor's software. If you have never been through the process, it is not cheap. It seems that it was not so long ago that \$75,000 to \$100,000 was an expensive data conversion. The costs have ballooned and are now well in excess of that amount. Keep in mind, these costs are different than the early contract termination fees.

Following receipt of the current provider's deconversion estimate, the bank moved forward with signing a contract with the new core provider. After doing so, they provided the appropriate information to the current provider to begin the deconversion process. One of the first things the current provider did was provide an invoice for the associated deconversion fee.

You can probably guess where this is going. The charged fee was significantly higher than the "estimate." When we say significantly, we mean hundreds of thousands of dollars. This was a shock to the bank. Unfortunately, we were not as surprised. This is not the first time we have seen this particular fact pattern.

The purpose of this *Musings* is not to slander the core providers. Instead, we view this as somewhat of a public service announcement to make your community bank aware of the circumstances. If your community bank is thinking about any type of event that would require a deconversion, either a change in core processor or an M&A transaction, keep these issues in mind. Unfortunately, our experience is such that the estimate of costs is sometimes not reflective of reality.

DIRECTOR CONFIDENTIALITY

We anticipate that most every reader of *Musings* knows that community bank directors have a number of specific duties, not the least of which is the duty of confidentiality. Of course, this duty imposes upon the director a requirement to keep all confidential information they obtain

in their position as a director confidential. Put another way, the requirement is to ensure that the confidential information discussed in the boardroom remains in the boardroom.

Many community banks have shareholders that own a material portion of the stock outstanding. This might be an individual, family group, or professional investor. In these circumstances, it is not all that uncommon for the investor to have what is essentially an investor representative on the Board of Directors. For example, a family that has material ownership may have a family representative on the board that is generally accepted as representing the family in speaking their voice for corporate matters.

In circumstances such as this, one of the issues that often comes up is the intersection of the director's duty of confidentiality and their role as representative of a larger group. It is not all that uncommon for the director to attend the board meeting and then take the information from the board meeting and report back to the family. Does the fact that it is not uncommon make it right?

Admittedly, this is somewhat of a difficult conundrum. The practical realities are that the individual is intended to, and generally accepted to be, the liaison between the board and the material shareholder. Legally speaking, however, we are not aware of any exception to the duty of confidentiality that applies when a director is generally seen as a liaison for a shareholder.

If you are a director that is in the position of being a liaison to a larger group, please do not take this as us griping at you. We are simply pointing out what we see as somewhat of a conundrum for what is a reality for many community banks across the country.

OPERATIONAL IMPROVEMENT

It used to be that fall was our "strategic planning season." Many boards choose to do their strategic planning in the fall in order to drive the budget and strategic action items for the next year. Recently, that has changed. We now do not know that we have a specific planning season. Instead, we are busy facilitating planning sessions year round.

Recently, we facilitated a number of planning sessions that all have a common theme: improving operational efficiency. For these banks, the central strategy is not one of asset growth, geographic expansion, or similar initiatives. Instead, these banks are satisfied with their current asset size and are looking much more to improve operational efficiency and net income than they are to achieve growth.

How does a bank improve operational efficiency? In our view, the answer is by taking a hard look at the bank's internal processes and procedures and reforming them where appropriate

to ensure the bank's employees are performing their respective tasks in the most efficient and productive manner possible.

Some banks choose to do this internally. Others choose to have us, or a similar service provider, come in. Either way, the process is generally the same. It really is taking a hard look at all of the material processes and procedures in the bank and asking how they can be done differently to be more efficient. This really is about getting away from the doctrine of prior decisions and looking to be very intentional in structuring what it is the bank's employees do and how they do it to be as efficient as possible.

TRANSACTION CONSIDERATION

We are currently assisting a couple different community banks in considering M&A transactions. These deals are not cash deals but are instead stock-for-stock transactions. In these deals, the acquiring holding company issues shares to the target holding company shareholders in exchange for ownership of the target holding company and target bank. Looking at it another way, it is essentially the target shareholders using the value of their company and bank to invest in a joint enterprise between the existing company and the acquirer.

In most community bank stock-for-stock transactions, at least one of the parties, and oftentimes both, have no ascertainable market value. Typically, both of the stocks have no real liquidity to speak of, and there are no established market prices by which to mathematically determine the relative value of the two shares to one another. When these circumstances exist in a community bank acquisition transaction, we generally look to a contribution analysis to determine the relative value of the two community bank holding companies' shares. It is essentially a way to determine the ownership split between the two shareholder bases following closing of the transaction by evaluating the contribution of each respective organization to the combined organization's earnings, equity, and assets.

In these types of transactions, the number of shares issued and the pro forma ownership split drives the transaction more so than the absolute dollar value of the acquirer's shares. This is because the absolute dollar value of the acquirer's shares in these types of transactions is often subjective and open to argument, at best.

If your community bank holding company is contemplating a stock-for-stock transaction, our suggestion is that the number of shares to be received by your shareholders is much more important to the analysis and negotiation than is the per share value assigned to the buyer's stock.

ICBA ENHANCING ORGANIZATIONAL VALUE CONFERENCE

On July 31-August 1, 2025, the ICBA is providing its second annual Enhancing Organizational Value Conference at The Westin Edina Galleria hotel in Edina, Minnesota. Philip Smith and Greyson Tuck will be the presenters/instructors. This is an in-person day and a half conference that will focus on strategies for community banks to create value, such as stock liquidity, capital raising and deployment alternatives, succession planning, employee attraction and retention, equity and equity-like compensation, mergers and acquisitions, and others. To check out further details and register for the conference, please visit the following link: [ICBA Enhancing Organizational Value Conference - July - Edina MN](#)

CONCLUSION

We hope all of you had a restful Memorial Day weekend and are ready to hit the ground running with the start of a new month and the end of the second quarter in sight.

Stay safe. See you in two weeks.

Jeff Gerrish

Philip Smith

Greyson Tuck

Upcoming Webinars and In-Person Presentations

- May 27 - June 6, 2025 - Southwestern Graduate School of Banking Foundation, Dallas Texas. “Enhancing Shareholder Value With or Without a Sale” (June 2-4) (Philip K. Smith, Instructor) Registration: [SWGSB](#)
- June 1-6, 2025 - Independent Community Bankers of America, Commercial Lending Institute at the Embassy Suites Grapevine, Texas (In-Person Event) (June 5) (Doc Bodine, Instructor) Registration: [ICBA Commercial Lending Institute - June - Dallas TX](#)
- June 3, 2025 - Independent Community Bankers of America – (Webinar) “Ensuring Your Next Strategic Planning Session is Not B.S. (Boring Stuff)” (Greyson Tuck, Presenter) Registration: [ICBA Webinar - Ensuring Your Next Strategic Planning Session is Not BS.\(boring-stuff\)](#)
- June 5, 2025 - Independent Community Bankers of America, Bank Director Forum-Session 2, “Keys to Being a Great Outside Bank Director” (Livestreamed Event) (Greyson Tuck, Instructor) Registration: [ICBA Bank Director Forum - Session 2 - June - Livestreamed](#)

- June 8-10, 2025 – Tennessee Bankers Association Annual Meeting at the JW Marriott, Marco Island, Florida (In-Person Event) “What’s Next for Tennessee Banking” (June 9) (Philip K. Smith, Presenter) Registration: [Tennessee Bankers Association Annual Meeting](#)
- July 7-9, 2025 – Community Bankers Association of Kansas, 2025 Annual Convention & Trade Show at the Kansas City, Missouri Marriott Downtown (In-Person Event) (July 8) (Philip K. Smith, Presenter) Registration: Not yet available.
- July 13-25, 2025 – Graduate School of Banking at Colorado, Class: “Enhancing Shareholder Value” (July 14-18) (Greyson Tuck, Instructor) Registration: [Graduate School of Banking at Colorado](#)
- July 27 – August 8, 2025 - Graduate School of Banking at the University of Wisconsin-Madison. “Enhancing Shareholder Value With or Without a Sale” (July 28-29) (Philip K. Smith, Instructor) Registration: [GSB-Wisconsin](#)
- July 31-August 1, 2025 - Independent Community Bankers of America, Enhancing Organizational Value Conference at The Westin Edina, Minnesota Galleria (In-Person Event) (Philip Smith and Greyson Tuck, Presenters) Registration: [ICBA Enhancing Organizational Value Conference - July - Edina MN](#)