GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Arkansas, California, Colorado, Mississippi, Tennessee, and Wisconsin!

UNIQUE BYLAW PROVISIONS

We often have community bank clients request that we review their governing documents. These are simply banks and holding companies that have not had their Articles of Incorporation or Bylaws reviewed in some time and want us to put a set of eyes on them to address their current status and any recommended changes. It is just a way to ensure the governing documents are up-to-date and in line with current organizational needs and corporate governance considerations.

We recently reviewed a set of bylaws for a bank whose bylaws had not been updated in over 100 years. The provisions were interesting. One notable provision required the President of the bank to be responsible for completion of the janitorial duties related to the branch locations. The bank President was surprised when it was pointed out this was part of his duties as President of the bank. If your bylaws have a similar provision, we expect there is a high likelihood the bank President is not scrubbing toilets and taking out the trash. If they are, we commend them for going above and beyond in today's environment!

One of the questions that came out of this somewhat humorous discussion relates to the ramifications of the failure to strictly comply with corporate bylaws. In other words, what happens if a bank or holding company does not strictly comply with its bylaw requirements and acts in a manner that deviates from their wording? The answer is, “not much.” The failure to strictly comply with corporate bylaws does not carry any significant penalty. The failure to strictly comply with the provisions of the articles of incorporation is a different story. It is more important to comply with those provisions.

If you have not done so lately, we think there is benefit in having your corporate governing documents reviewed and updated. If you find unique provisions that are not of significant importance that are not being complied with, do not lose too much sleep over it. It is more important to comply with the material provisions of the bylaws and the articles of incorporation.

THE PATH OF LEAST RESISTANCE

We are currently assisting a couple of different community bank holding companies with capital raising transactions. We are currently working on a number of different Private Placements of Common Stock and are assisting a couple different holding companies with holding company debt. Some of those are structured as bank stock loans while others are new issuances of Subordinated Debt.

The varying nature of these projects has reminded us that capital raising is really about moving forward with the path of least resistance. Simply put, each of these capital raising alternatives has the same goal of raising cash to pursue some corporate activity. How that cash is raised is distinct and is based on each organization’s unique circumstances. Each of these community bank holding company Boards has determined the path of least resistance to raise the amount of cash that needs to be raised given their individual circumstances. These capital strategies all tie back into current corporate positioning and each organization’s overall strategic plan.

There are many ways community banks can raise capital. If you are considering a capital raising alternative, we expect the path that is ultimately chosen will be that of least resistance to get the cash that is needed to complete whatever needs to be completed. That path of least resistance is identified by looking at both the corporate goal to be achieved and the various considerations that are related to the different capital raising structures.

SUBORDINATED NOTES

Speaking of capital, we see Subordinated Notes as "making a comeback." Why do we say Subordinated Notes are making a comeback? Part of our informal analysis relates to the amount of work we are currently doing for clients as it relates to Subordinated Note issuances.

We are currently assisting a number of community bank holding company clients in issuing Subordinated Notes. What is interesting is that most of these transactions involve some type of refinance of existing Subordinated Notes. Many of the holding companies issued Subordinated Notes in 2021. Those Subordinated Notes cannot be redeemed for the first five years after their issuance. After the five-year lockout period, those Subordinated Notes can be redeemed and refinanced. Based on the changes in interest rates since that time, these holding companies believe it is a better alternative to refinance the existing debt and fix the rate for an additional five years rather than keep the original issuance outstanding at its reset interest rate that varies based on market changes.

We expect new issuances of Subordinated Notes will increase over the next year or so. This will provide the holding companies with the opportunity to issue new debt and to refinance existing Subordinated Notes, and it will also provide many banks the opportunity to invest in these debt issuances.

COMPENSATION STUDIES

It is not all that uncommon for our firm to be engaged to conduct a compensation study. As the name implies, these types of projects are detailed analysis and comparison of a particular bank's compensation practices to that of the industry as a whole. Compensation studies are typically completed by comparing the specific compensation paid to individuals within an organization and comparing that to peer group averages and other percentiles through the use of salary surveys. It typically includes an analysis of base compensation, incentive compensation, and additional benefits. The point of the study is to allow a Board of Directors or Compensation Committee to understand how the bank is positioned as it relates to the payment of compensation when compared to similarly situated banks.

Some Boards utilize compensation studies on a routine basis to ensure their compensation keeps in line with the industry to maintain their position as a competitive employer. Others do not utilize them at all. Some utilize them on a sporadic basis. If you are not utilizing any type of compensation study, you might want to consider it. Given the competitive landscape for talent today, your community bank simply cannot afford to be deficient in compensation while trying to attract and retain talent.

ESOP EMERGING LIABILITIES

Many community banks have Employee Stock Ownership Plans. If a community bank has an ESOP, one of the considerations relates to the ESOP emerging liability. Simply put, the emerging liability is the forthcoming liability that is associated with expected participant retirements and the need to convert their holding company stock accounts in the ESOP to cash as part of their retirement savings.

Participants that leave a plan typically do not take stock. In S corporations, they are prohibited from doing so. In C corporations, they typically do not because cash is the preferred asset in retirement rather than holding company shares.

Assuming cash is requested, there are a couple different cash sources that can be used to purchase the shares from the retiring participant's account. The first is cash within the plan. This is typically referred to as "recycling" within the plan. Simply put, the third-party administrator takes a little bit of cash from each of the participant's accounts and uses the collective cash account balance to repurchase the shares from the retiring participant. It then takes the shares and reallocates them to the remaining participants based on the cash taken from each respective participant. They are essentially swapping assets for the remaining participants by taking cash from them and replacing it with stock.

The other alternative is for the holding company to repurchase the shares. For non-publicly traded companies, the retiring participant has a put option on the holding company that requires the holding company to repurchase the shares. So, if the plan cannot come up with the cash, the participant can take stock from the plan and then immediately require the holding company to purchase the stock. This law is in place to avoid retiring participants from being stuck with a non-liquid stock as part of their retirement.

For ESOP trustees and third-party administrators, the ESOP emerging liability is an important item of consideration. The overall strategy is one of ensuring the emerging liability is understood and having some plan in place to address the emerging liability. We have conducted dozens of emerging liability studies for community banks and holding companies. Please let us know how we might assist.

DISCOUNTED SALES OF COMMON STOCK

We are currently assisting a couple of different community bank holding company clients in determining the appropriate structure for executive equity compensation. The opportunities are expansive. They range from stock options and stock grants to stock appreciation rights and phantom stock plans.

For a couple of our clients, they are beginning to hone in on the strategy of offering stock for sale to executive officers at a discount to fair market value. For example, if the stock has a fair market value of $100, the stock would be offered to the executives at $50. This is to entice the executives to invest and to give them somewhat of a benefit by purchasing shares at half price.

The discounted sale of stock to executives is certainly a strategy that is available and worth considering. It entices executives to purchase the shares by offering them at a discount. That results in actual equity ownership by the officers, which many Boards view personal investment of those running the bank as a good thing.

If stock is sold to executives at a discount, there are some tax ramifications that need to be considered. Simply put, the difference between the sales price of the fair market value of the stock at the time of issuance is taxable to the executive as compensation. This could potentially make the investment a little less attractive because it requires the executive to come out of pocket with cash to complete the purchase of shares and cash to pay the tax on the discounted amount.

We have a detailed Memo to Clients & Friends that addresses executive equity compensation alternatives. It is a good overview of the different available alternatives and their considerations. Please let us know if you would like a copy. We are happy to provide it.

FEDERAL RESERVE REQUIREMENTS

Over the past couple of weeks, we have had a couple similar discussions with clients that are frustrated with the Federal Reserve's requirements for filing a Notice of Change in Control—more specifically, the requirement for shareholders to file a Notice of Change in Control. If you are not familiar with the Notice of Change in Control process, it generally includes a requirement that any shareholder owning 2% or more of the shares outstanding complete an Interagency Biographical and Financial Report, also known as an IBFR.

If you have never seen the IBFR, it is what we believe is properly characterized as "invasive." It is approximately a 17-page document that is partially dedicated to an individual's biographical background and partially dedicated to the individual's current financial situation. The background portion asks several questions, including items such as whether you have ever been charged with a crime, been involved in a bank that is in troubled condition, settled any lawsuit, been accused of any fraud with the government, and similar circumstances. The financial portion is equally invasive, and it includes a requirement to provide detailed personal financial information such as a balance sheet, statement of cash flows, listing of assets and securities owned, explanation of liabilities and contingent liabilities, and the like.

We have recently had a couple of different shareholders of clients that are particularly not impressed with the Federal Reserve's expectations and requirements. The question that has been asked is what happens if they simply refuse to complete the IBFR. In short, our answer is that the Federal Reserve will either expect the shareholder to divest shares to remove themselves from a control position or could potentially impose civil money penalties.

Technically speaking, a violation of the Change in Bank Control Act carries with it the possibility that the Federal Reserve can implement civil money penalties of up to $1,250,000 per day for each day that the violation continues. We recognize that is a pretty heavy hammer and typically is enough encouragement for shareholders to begrudgingly complete the IBFR. It is important to note that we cannot recall in recent memory a situation that we have seen where the Federal Reserve has actually implemented civil money penalties for the Change in Bank Control Act.

CONCLUSION

We are in the midst of the dog days of summer. For many kids around the country, school is in the not-too-distant future. Whatever your circumstances, we hope you are enjoying the final days of summer. Stay cool.

See you in two weeks.

Jeff Gerrish *Philip Smith* *Greyson Tuck*

Upcoming Webinars and In-Person Presentations:

- August 2-6, 2026 – Independent Community Bankers of America, "Commercial Lending Institute" (Cliston V. "Doc" Bodine, III presenting) Registration: ICBA Commercial Lending

- August 19, 2026 – Independent Community Bankers of America, "ICBA Credit Analyst Institute" (Cliston V. "Doc" Bodine, III presenting) Registration: ICBA Credit Analyst

- August 24-28, 2026 – Pacific Coast Banking School, "The Board, Shareholders and M&A: Legal and Practical Concerns" (Philip K. Smith, Instructor) Registration: PCBS

- September 10 & 11, 2026 – Independent Community Bankers of America, "Enhancing Organizational Value Conference" (Philip K. Smith and Greyson E. Tuck presenting) Registration: Enhancing Organizational Value Conference

- September 15, 2026 – Independent Community Bankers of America, "Regulation O for Community Banks" (Cliston V. "Doc" Bodine, III presenting) Registration: Regulation O Webinar

- September 16-18, 2026 – Community Bankers of Michigan 2026 Annual Convention & Expo – Directors' College, held at Grand Traverse Resort, Traverse City, Michigan. "Ask Me Anything…" (Sept. 16) (Philip Smith, presenter). Registration: Community Bankers of Michigan - Directors' College

- October 19-21, 2026 - Southwestern Graduate School of Banking at Southern Methodist University SMU Cox School of Business, National Certified Community Bank Directors' (NCCBD) Program. "Corporate Governance and the Role of a Board Member, Board Culture" and "Board Members, Board Committees, Board Composition." (Oct. 19) (Philip Smith, Presenter) Registration: National Certified Community Bank Directors' Program

Acquisition Pricing:
All Bank Transactions

	All Deals in the U.S. Over the Past 12 Months Where the Target Has:		
	Less than $250 Million in Total Assets	Between $250 Million and $1 Billion in Total Assets	Between $1 Billion and $5 Billion in Total Assets
Number of Deals	63	44	36
Average Price/Book (%)	167.71	128.85	146.90
Average Price/Tangible Book (%)	170.46	132.11	154.82
Median Price/Earnings (x)	26.39	15.74	15.77
Average Price/Assets (%)	22.58	12.87	13.43
Average Price/Deposits (%)	24.20	14.36	14.29
Median Premium/Core Deposits (%)	11.48	3.92	6.65

* Through July 29, 2026
** Source: S&P Global Market Intelligence

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