THE Board Chair Forum

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys

September 2022

Sometimes in our Firm's practice we seem to go through cycles where nothing quite seems normal, we encounter unusual circumstances, there are sometimes funny stories and sometimes interesting developments. Recently, it seems as though we have been in one of those times, and a number of these issues and situations raise concerns that might be appropriately addressed by the Board Chair or at least deal with director issues. So, we wanted to outline some of those in this month's edition for you.

We have also noticed recently that directors are starting to get quite a bit of attention, and there seem to be multiple educational opportunities and seminars and other events targeted towards directors. We think most of those can be very productive including, obviously, the ones with which we are involved. However, make sure as you and your directors are becoming educated that you attend the conferences that focus on the needs that would be relevant to your organization. For example, there may be no need for a community bank board of directors to attend a conference dealing with legal and fiduciary duties of SEC-reporting company directors. Likewise, directors of an SEC-reporting company probably would not need to attend a conference primarily geared toward unique issues facing directors of Subchapter S organizations. Those are two different worlds and your directors need education that meets their specific needs. So, as we offer up another round of information, we hope you find it applicable to your board, and find it interesting and informative. As always, keep us in mind if we can help.

Sincerely,



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

Buyers Don't Always Understand

As most of you are probably aware, the merger and acquisition market is still fairly "robust". While we are staunch proponents of community bank independence, we are also honored every time a bank asks us to represent it with what is really the most important of obligations in helping an organization pursue a sale or find a buyer. An organization is only going to get one shot at doing a sale right, and it is always humbling to us that people would trust us with that endeavor, so we always strive for the utmost benefit, as well as the utmost protection.

Because we take that obligation so seriously, we often find ourselves having to defend the board of directors of a potential selling bank or the ownership or a family from a possible buyer who simply does not "get it". By that, we mean that too often a buyer that may be buying a smaller community bank or a family-owned bank seems to think that they are doing the selling bank a favor. So, when a potential seller requests the opportunity to conduct its own due diligence, questions the particular structure of a transaction, or simply asks for certain things that will benefit the seller, the buyer sometimes becomes frustrated. We have even had buyers suggest that if the seller does not quit asking for so many things and questioning what the buyer is doing that the buyer is going to "take their marbles and go play elsewhere." In most of those circumstances the best thing is to let them take their marbles and go play elsewhere!

We have even encountered circumstances where a buyer began to question whether a bank really even wanted to sell. Why do they keep negotiating the price? Why do they want us to demonstrate our ability to pay the consideration? Why are they asking for a commitment from our bank to their existing community post-closing? Again, many of these buyers do not understand that there is more to a potential sale than merely dollars and cents. In fact, the board of a selling organization should always consider not only the economic factors but also the impact a potential transaction might have on the selling organization's community, employees, customers, as well as shareholders. In that sense, the directors rightfully focus on how a potential transaction impacts "stakeholders", which is a much larger group than just shareholders.

So, as we often preach, if an organization makes the tough decision to pursue a sale, they do not immediately lose all negotiating leverage. Rather, the smart organization pursues the sale at a time when they are not backed into a corner and feel like they have to sell. That gives them substantial negotiating leverage to work an even better transaction for all stakeholders. Smart buyers, by the same token, will not assume that a selling bank is fortunate to have the buying bank ride in on their white horse and save the bank from further trouble. Rather, the smart buyer will look at a target as a potential benefit to the combined organization and find ways to reward the seller for the value they are bringing to the transaction, and try to make the transaction as simple and as smooth as possible for the seller.

A Word of Caution about Lawyers!

Many of you may recall a year or two ago the form letters many banks got claiming that their websites were not ADA (Americans with Disabilities Act) compliant. There were some large, predominantly East Coast law firms sending out these kind of demand letters and trying to reach settlements with banks since their websites were (allegedly) not compliant. Of course, sending these kinds of mass mail letters give lawyers a bad name, like lawyers chasing asbestos claims or other types of potential mass class action lawsuits. However, there is another round of this going on in a different area.

Recently, we have encountered a few situations across the country that are similar. One or more law firms are beginning to send "notice" letters to different banks around the country related to overdraft fees. The letters basically indicate that the law firm represents an existing or former customer of the bank who has been charged overdraft fees in a way that is believed to be contrary to the bank's stated policies, or that policies of the bank are misleading, or that the customer never

agreed to the manner in which overdraft fees are applied, etc. Are these just massive form letters that are sent out all over the country from a law firm to try to get any bank to settle for a quick payment and make the matter go away? Well, at least one of our bank clients recently received one, which referred to our bank as a credit union, so what do you think?

Notwithstanding the difficulty of dealing with these kinds of potential lawsuits, which tend to originate from a customer hearing an ad on the radio or seeing a 1-800 number to call at the back of a publication, you should not take them lightly and should seek some professional assistance in order to respond. It may be that there is some validity to the claim and the bank certainly does not want to have more exposure than it might otherwise. So keep your eyes peeled and make sure the management team is on the lookout for these kinds of demand letters.

Rethinking Stock Ownership

Should directors own stock? Generally speaking, most of our clients take the traditional approach of, of course, we want them to have "skin in the game". The general thought is that if a director is required to own stock, they will be a little more careful in their overall decision making since they are managing their own money along with other stockholders' money. The argument continues that we are aligning the interests and concerns of the directors with the interests and concerns of other stockholders and that can certainly lead to better results. So, generally speaking, most bank directors do in fact own stock in the organization upon which they serve.

However, we have recently had some discussions with directors rethinking that notion. Not totally doing away with it by any means, but asking the question of whether, in the recruitment of new directors, they should require the director to buy stock. Directors have recently outlined for us a number of reasons why that might not be a good idea. For example, requiring some minimum stock ownership may mean a sizeable investment in the company and may reduce the pool of potential candidates who can serve. Do we necessarily need the wealthiest among us to serve on our board? Likewise, one board chair told us that by not requiring stock ownership they felt like they could better recruit younger board members.

We also had another board chair who took the position that if allowing directors to serve without having stock ownership was put into place, they believe it might give the director a totally free and independent view of the organization, not restricted to how a decision might impact their own investment. Therefore, they might be willing to promote new types of lending, new products and services, or growth opportunities that might restrict dividends but provide better overall value to

the organization in the future. So, this is a call to rethink our traditional ways of thinking and our traditional ways of doing things, where we always assume that stock ownership or skin in the game is the best route. Let's don't keep doing things the same way just because we always have and, instead, let's ask if we have the right people (directors) in the game, regardless of stock ownership. Stock ownership may not be a prerequisite any longer to be a fully engaged and vibrant board member.

Banking as a Service and Regulatory Concerns

As we have been saying since at least the beginning of the year there seems to be a national shift in new areas of emphasis among the regulatory agencies. Chief among those have been risk management and vendor management concerns. Often, when we are facilitating strategic planning sessions, we see that a board may have rarely focused on the concept of risk management as an actual strategic principle even though they may inherently make their decisions considering various elements of risk. Our experience is showing that specific and targeted risk management practices and procedures are now being mandated by the regulators.

The relatively new emergence of the concept of "banking as a service" is an area that is both exciting and challenging, but may also present additional areas of potential regulatory concern. Banking as a service typically is the term used to mean when a non-bank company offers banking products that are provided through a licensed bank without facing the regulatory hurdles of actually forming a bank. As we have sometimes cynically pointed out, this is almost like saying banks are too boring to be able to offer cool techy products and the cool techy companies want to access the bank's customer base but cannot get regulatory approval to buy a bank. So, the idea is to allow the tech company to offer its products "through" the bank.

An example may be where a customer can complete a banking transaction at a company website level without having to complete a separate transaction through the actual bank website. It allows the non-bank company to monitor company transactions such as how much the customers are spending or what they are purchasing with the funds. However, in evaluating these types of new services, the bank can be subject to additional criticism for third-party risk management, Bank Secrecy Act and anti-money laundering risk management, suspicious activity reporting, information technology control and overall risk governance. The results may be some type of enforcement action that among other things might require a bank to adopt and implement a third-party risk

management program, complete a BSA risk assessment, adopt a BSA audit program and similar functions.

The bottom line is that regulators are taking a renewed look at these kinds of areas and banks should not enter into those types of relationships without a well-structured overall risk management process.

Meeting Adjourned

From our standpoint the year seems to be flying by. Because of that, it is not too early to begin looking forward to 2023 and, in fact, our Firm has already booked numerous strategic planning sessions, client meetings and other work for 2023. As part of the new year, we wanted to remind you, of course, of the Community Banking Board Chair Forum that we host every year in Naples, Florida. This year's event will be January 9 and 10, 2023 and we once again expect to have directors, board chairs and other executive management from across the country joining us. To reserve your spot, go ahead and sign up now and you may do so using the following link: Community Banking Board Chair Forum. In addition, we are always looking for ways to improve that meeting, so if you have topics you would like for us to cover or suggestions for the format, please let us know.

Let's all keep pushing toward the end of the year and if we can help you in any way, please let us know.

Until next time,

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.