Remaining Independent: Community Bank Directors' Conference

Presented by:

Philip K. Smith, Chairman & CEO
Greyson E. Tuck, President
Gerrish Smith Tuck, Consultants & Attorneys

Presented at:
Community Bankers Association of Illinois
Remaining Independent: Community Bank
Directors' Conference
April 1, 2025
Northfield Inn & Conference Center
Springfield, Illinois

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One Mission. Community Banks.®

GERRISH SMITH TUCK
Consultants and Attorneys

Philip K. Smith

Mr. Smith is the Chairman and Chief Executive Officer of the Board of Directors of the Memphis-based law firm of Gerrish Smith Tuck, PC, and its affiliated bank consulting firm, Gerrish Smith Tuck Consultants, LLC. Mr. Smith's legal and consulting practice places special emphasis on bank mergers and acquisitions, financial analysis, acquisition and ownership planning for boards of directors, strategic planning for boards of directors, regulatory matters, bank holding company formations and use, securities law concerns, new bank formations, S corporations, going private transactions, and other matters of importance to banks and financial institutions.

Mr. Smith is a frequent speaker to boards of directors and a presenter at numerous banking seminars. He received his undergraduate business degree and Masters of Business Administration degree from the Fogelman School of Business and Economics at The University of Memphis and his law degree from the Cecil C. Humphreys School of Law at The University of Memphis. He is authoring a monthly electronic newsletter, The Chair's Forum Newsletter, which discusses key topics impacting financial institutions and, specifically, the role of the Chair. Mr. Smith is a Summa Cum Laude graduate of the Barret School of Banking where he has been a member of the faculty. He has also served as a member of the faculty of the Pacific Coast Banking School, the Colorado Graduate School of Banking, the Southwestern Graduate School of Banking and the Wisconsin Graduate School of Banking.

GERRISH SMITH TUCK, PC, ATTORNEYS
GERRISH SMITH TUCK CONSULTANTS, LLC
700 Colonial Road, Suite 200
Memphis, Tennessee 38117
(901) 767-0900
Email: psmith@gerrish.com

Greyson E. Tuck

Mr. Tuck is President of the Board of Directors of both the Memphis based law firm of Gerrish Smith Tuck, PC, Attorneys and Gerrish Smith Tuck, Consultants, LLC. These two firms have assisted numerous community banks in virtually every state across the nation. Mr. Tuck's legal and consulting practice places special emphasis on community bank holding company formation and use, community bank mergers and acquisitions, regulatory matters, corporate reorganizations, corporate taxation, general corporate law and community bank strategic planning. Mr. Tuck comes from a community banking family. He is a graduate of the University of Tennessee, where he majored in Accounting and Finance, and received his law degree from the University of Memphis Cecil C. Humphreys School of Law, where he was a Herff Scholar. Mr. Tuck is a graduate of the Paul W. Barret, Jr. School of Banking and currently serves as a faculty member at a number of banking schools across the country. He is a frequent presenter at national and state bank association conferences and has authored a number of articles of interest to financial institutions. Mr. Tuck is a member of the Tennessee Bar Association. Mr. Tuck can be contacted at gtuck@gerrish.com or (901) 767-0900.

Gerrish Smith Tuck Consultants, LLC and Gerrish Smith Tuck, PC, Attorneys offer consulting, financial advisory and legal services to community banks nationwide in the following areas: strategic planning; mergers and acquisitions, both financial analysis and legal services; dealing with the regulators, particularly involving troubled banks, memoranda of understanding, cease and desist orders, consent orders and compliance; structuring and formation of bank holding companies; capital planning; employee stock ownership plans, leveraged ESOPs, KSOPs and incentive compensation packages; directors and officers liability; new bank formations; S corporation formations; going private transactions; and public and private securities offerings. Gerrish Smith Tuck, PC, Attorneys has been ranked as high as third nationally by number of transactions in bank mergers and acquisitions.

GERRISH SMITH TUCK, PC, ATTORNEYS
GERRISH SMITH TUCK CONSULTANTS, LLC
700 Colonial Road, Suite 200
Memphis, Tennessee 38117
(901) 767-0900
Email: gtuck@gerrish.com

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CONSULTING ♦ FINANCIAL ADVISORY ♦ LEGAL

Mergers & Acquisitions

Analysis of Business and Financial Issues
Target Identification and Potential Buyer Evaluation
Marketing Process and Acquirer Identification
Preparation and Negotiation of Definitive Agreements
Preparation of Regulatory Applications
Due Diligence Reviews
Tax Analysis
Securities Law Compliance
Leveraged Buyouts
Anti-Takeover Planning
Financial Modeling and Analysis
Transaction Pricing Analysis
Fairness Opinions

Bank and Thrift Holding Company Formations

Structure and Formation
Ownership and Control Planning
New Product and Service Advice
Preparation of Regulatory Applications
Financial Modeling and Analysis

Financial Modeling and Analysis

Financial Statement Projections
Business and Strategic Plans
Ability to Pay Analysis
Net Present Value and Internal Rate of Return Analysis
Mergers and Acquisitions Analysis
Subchapter S Election Analysis

General Corporate Matters

Corporate Governance Planning and Advice
Recapitalization and Reorganization Analysis and Implementation
Board and Management Review and Evaluation
Cybersecurity Incident Response and Management

Capital Planning and Raising

Private Placements and Public Offerings of Securities
Bank Stock Loans
Capital Plans

Subchapter S Conversions and Elections

Financial and Tax Analysis and Advice
Reorganization Analysis and Restructuring
Cash-Out Mergers
Stockholders Agreements
Financial Modeling and Analysis

Taxation

Tax Planning
Tax Controversy Negotiation and Advice

Strategic Planning Retreats

Customized Director and Officer Retreats
Long-Term Business Planning
Assistance and Advice in Implementing Strategic Plans
Business and Strategic Plan Preparation and Analysis
Director Education

Executive Compensation and Employee Benefit Plans

Employee Stock Ownership Plans
401(k) Plans
Leveraged ESOP Transactions
Incentive Compensation and Stock Option Plans
Employment Agreements-Golden Parachutes
Profit Sharing and Pension Plans

New Bank and Thrift Organizations

Organizational and Regulatory Advice
Business Plan Creation
Preparation of Financial Statement Projections
Interagency Charter and Federal Deposit Insurance Application Preparation
Private Placements and Public Stock Offerings
Development of Bank Policies

Bank Regulatory Guidance and Examination Preparation

Preparation of Regulatory Applications
Examination Planning and Preparation
Regulatory Compliance Matters
Charter Conversions

Problem Banks and Thrifts Issues

Examiner Dispute Resolution
Negotiation of Memoranda of Understanding and Consent Orders
Negotiation and Litigation of Administrative Enforcement Actions
Defense of Directors in Failed Bank Litigation
Management Evaluations and Plans
Failed Institution Acquisitions
New Capital Raising and Capital Plans
Appeals of Material Supervisory Determinations

Estate Planning for Community Bank Executives

Wills, Trusts, and Other Estate Planning Documents
Estate Tax Savings Techniques
Probate

Other

Public Speaking Engagements for Banking Industry Groups (e.g., Conventions, Schools, Seminars, and Workshops)
Publisher of Books and Newsletters Regarding Banking and Financial Services Issues
Expert Witness and Litigation Support Services

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www.gerrish.com

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Housekeeping Matters

- Lecture / Peer Discussion
- Interactive
- Breaks
- Lunch

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Assuring Independence by Enhancing Shareholder Value

The fundamental duty of community bank directors and executive officers is to enhance shareholder value, evidenced by:

- Stakeholder relevance
- Earnings per share growth, ideally at least 8% annually
- Appropriate return on equity, ideally at least 10% annually
- Common stock liquidity
- Appropriate dividends or "dividend equivalent" distributions
- Maintenance of satisfactory regulatory relations

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What are the key characteristics of the current banking environment?

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Current Banking Environment

- Significant economic, political and global uncertainty
- Interest rate uncertainty
- Deposit warfare
- Loan demand remains adequate
- NIM compression
- Lack of "excess capital"

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Current Banking Environment

- Asset quality remains strong (question is whether that will hold)
- Consumer protection is a major compliance concern
- Evolving community bank M&A activity
- Continued industry contraction
- Aging shareholder base

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Stakeholder Relevance

- Community bank stakeholders
  - Shareholders
  - Borrowers
  - Depositors
  - Employees
  - Community
  - Regulators

The fundamental obligation is to identify and achieve key aspects of relevance for each of these stakeholder groups.

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Shareholder Relevance

- Enhance shareholder value
- Earn right to remain independent
- Changing needs of an aging shareholder base
- Current and future shareholder considerations

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Borrower Relevance

- Appropriate loan products
- Lender flexibility
- Timely and efficient process
- Technology considerations

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Depositor Relevance

- Relevant products and services
- Treasury management services
- Flawless customer experience
- Technology considerations

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Employee Relevance

- Fair cash compensation
- Incentive & equity-based compensation
- Employer flexibility
- Talent development
- Career pathing

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Community Relevance

- We aren't called community banks for nothing
- Community support
- Local ownership
- Marketing & community outreach

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Regulatory Relevance

- Maintenance of regulatory safety and soundness
- Current regulatory hot topics
  - Consumer compliance
  - Liquidity
  - Asset quality
  - Cyberfraud & data security
- Current regulatory environment

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Things You Need to Know to Fulfill Your Role

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Your Focus Should Have Already Shifted

- From shareholders to stakeholders
- From viability to relevance

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Directors Must Be Engaged

- Director evaluation?
- Director expectations?
- A job description?
- But I have a lot going on right now

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Your Board Meetings Need to Change

- Whose meeting is it?
- Not enough information? Or too much information?
- 90 days past due? Or future past due?
- Look forward, not rearward
- Consent agenda
- Strategic discussions

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Know How to Use Technology

- Ask and understand the Bank's products
- Force yourself to learn how to use them
- Lead by example

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Strategic Planning Doesn't Happen on Paper

- Use it to evaluate what you are doing
- Use it to challenge the status quo
- Use it to address difficult questions
- Focus on the results, not the process

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Six Common Mistakes of Remaining Independent

- Assuming it can be done passively
- Not focusing on core profitability
- Not planning board and management succession
- Not keeping up with changing regulations
- Not creating value
- Not staying relevant

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Community Bank Strategic Planning

- Strategic planning overview
- Key planning considerations
- Substantive strategic issues

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Regulatory Requirements

- No specific regulatory requirement
- General regulatory expectation
- Troubled bank requirement

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Planning Retreat Considerations

- Structure of retreat
- Invited parties
- Timing
- Location

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Preliminary Considerations During Planning Retreat

- Discussion of national and local economic events
- Market analysis and survey
- Director education
- Officer / Director cohesion

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Mechanics of The Strategic Plan

- Current analysis
- Discussion of key issues
- Consensus decisions
- Assignment of responsibility
- Development of timeline
- Follow-Up

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Making The Most of Strategic Planning

1. Don't focus too much on SWOT
2. Once your mission statement is set, leave it alone
3. A planning session is not a budgeting session
4. Address "real" issues
5. Don't focus too much on process

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Making The Most of Strategic Planning

6. Be honest (with yourself and others)
7. Make efficient use of time
8. Make the event enjoyable
9. One person should not dominate the meeting
10. Assign responsibility and follow-up

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Current Environment: The Impact on Strategy

- Economic outlook
- Interest rate environment
- Risk tolerance
- Alteration of prior strategy

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Independence: The Preliminary Decision

- Are we a buyer, seller or neither?
- Can we do a better job for our shareholders than another holding company's stock or cash?
- Can we make an acquisition and enhance shareholder value?
- Independence is conceptual Board determination
- Proactive or reactive independence strategy?

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Business Strategy?

- Growth
- Profitability
- Blended strategy

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Substantive Strategic Planning Issues

- Organizational structure/ownership issues
  - Bank holding company
  - S Corporation
  - Public or private
- Capital adequacy considerations: Enough cushion? Is more capital needed?

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Substantive Strategic Planning Issues

- Increase profitability
  - Loan growth
  - Deposit growth
  - Interest income and expense issues
- Non-interest income and expense issues

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Substantive Strategic Planning Issues

- Geographic expansion
  - Proactive or reactive?
  - What should the footprint look like?
- Controlling your own destiny
  - Strategy for addressing unsolicited offers

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Substantive Strategic Planning Issues

- Technology considerations
  - Internal technology
  - External technology
  - Technological efficiencies
- Regulatory/Compliance issues

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Substantive Strategic Planning Issues

- Shareholder liquidity
  - Repurchase planning
  - ESOP
  - Create market for common stock
- Succession issues
  - Management
  - Board of Directors

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Substantive Strategic Planning Issues

- Employee and Director benefit issues
  - ESOP
  - Stock option plans
  - Retention agreements
  - Employment agreements
  - Unusual ideas
- Dividend policy
  - Cash/stock
  - Dividend reinvestment plan

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Substantive Strategic Planning Issues

- Products, services & lines of business
  - Insurance
  - Securities
  - Real estate
  - Trust
  - Asset management
  - Financial planning
  - Finance company
  - Investment in other banks

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Conclusion

- Strategic planning is not a waste of time if done properly
- Find a process that works best for your organization
- Form independence and basic business strategy and then determine action items from there

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Maximizing Net Income

- Understand the Secret Formula:

  Revenue – Expenses = Profit

- Deconstruct the Income Statement
  - Sources of Revenue and How to Increase
  - Expenses and How to Reduce
  - Diversity: New Model

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Net Income Strategies

- Revenue generation
  - Increase loan-to-deposit ratio
  - Reposition securities portfolio
  - Alternative lines of business
  - Fee income opportunities

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What are some unique strategies your bank has employed to realize additional revenue generation?

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Expense Reduction

- Branch sale or closure
- Contract negotiations
- Non-cash compensation strategies
- Holding company debt principal and/or interest rate reductions

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What are some unique strategies your bank has employed to realize expense savings?

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Bank Capital Requirements

- General Capital Requirements
- Minimum Regulatory Capital Ratios
- Requirements in the Current Environment
- Appropriate Capital Level Above Minimums is a Board Determination
- Board Obligation to Enhance Shareholder Value

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PCA Categories

PCA Category	Total RBC Ratio	Tier 1 RBC Ratio	CET1 RBC Ratio	Tier 1 Leverage Ratio
Well Capitalized	10%	8%	6.5%	5%
Adequately Capitalized	8%	6%	4.5%	4%
Undercapitalized	<8%	<6%	<4.5%	<4%
Significantly Undercapitalized	<6%	<4%	<3%	<3%
Critically Undercapitalized	Tangible Equity / Total Assets ≤ 2%			

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Bank Holding Company Capital Requirements

- Large Bank Holding Companies
  - Tier 1 Capital to Total Assets – 4%
  - Total Capital to Total Assets – 6%
  - Higher Expectations in Today's Environment
- Small Bank Holding Companies
  - No Holding Company Minimum Ratios
  - Capital Evaluation on Bank Only Basis

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Sources of Community Bank Capital

- Holding Company Line of Credit
- Holding Company Secured Debt
- Holding Company Subordinated Debenture (Unsecured Debt)
- Sale of Equity Instruments
  - Common Stock
  - Preferred Stock
  - Other Equity-Type Instruments

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Small BHC Policy Statement

- Applicable to BHCs with Less Than $3 Billion in Consolidated Assets
- Bank Only Capital Evaluation
- Debt to Equity Limitations
- Dividend Limitations – No Dividends if Debt to Equity Exceeds 100%

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Bank Holding Company Debt

- Raise Cash at Holding Company Level
- Leverage Cash to Bank
- Increases Surplus on Common Stock
- Counts as Tier 1 Capital at Bank Level

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Line of Credit

- Prior Approval up to Specified Amount
- Optional Withdrawals
- Source – Bankers Bank or Correspondent Bank
- Generally Secured

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Senior Debt

- Specific Dollar Amount Repaid Over Specific Time Period
- Sources
  - Bankers Bank
  - Correspondent Bank
  - Director
  - Executive Officer
  - Other Sources

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Senior Debt

- Terms
  - Fixed or Variable Interest Rates
  - Interest Only
  - Repayment Terms
  - Secured or Unsecured
  - Early Repayment

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Subordinated Debt

- Specific Dollar Amount Typically Requiring Only Interest Payments
- Sources
- Term
- Amortization
- Interest Only
- Unsecured
- Subordinated to Senior Debt
- Other Terms

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Sale of Equity Considerations

- Equity Instrument to be Offered
- Exempt or Registered Offering
- Pricing
- Terms and Features
- Will it be Purchased?

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Exempt Sale of Equity

- Sale of Stock without SEC Registration
- Regulation D Rule 506 Most Common Exemption
- Intrastate Offering Exemption
- Other Available Exemptions

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Regulation D Rule 506

- Sale of Common Stock to Unlimited Number of "Accredited Investors" and No More Than 35 Non-Accredited Investors
- Disclosure Requirements Depend On Whether Sale Is Open To Non-Accredited Investors
- No General Solicitation of Offering Unless Open Only to Accredited Investors

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Accredited Investors

- Directors and Executive Officers of Issuer
- Individuals with $1 Million Net Worth (Excluding Equity in Primary Residence)
- Net Income of $200,000 Individually or $300,000 with Spouse for Each of Past Two Years with Expectation of Same for Current Year
- Other Criteria

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Rule 506 Notice Requirements

- File Form D with SEC
- File Copy of Form D in Each State in Which Shares Are Sold
- Timing Requirements
- Failure to Properly File Can Disqualify Ability to Rely on Rule 506 for Future Offerings

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Other Available Registration Exemptions

- Rule 504 or 505 Offerings
- Regulation A
- Intrastate Offering

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Regulation A+

- Enacted in JOBS Act
- Expansion of Regulation A to Allow Offerings of Up to $50 Million a Year without SEC Registration
- Requires Filing of an Offering Statement

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Restricted Securities

- Shares Sold in an Exempt Offering Are "Restricted" Securities
- SEC Prohibitions on Resell of Restricted Securities
- Rule 144A Safe Harbor Requirements
- Applicable to Control Securities Also

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Common Stock Liquidity Concerns

- The absence of stock liquidity results in:
  - Unhappy shareholders
  - Clearance rack pricing multiples
  - Exposure to unwanted takeovers
  - Diminished ability to maintain independence

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Strategies Impacting Alternatives

- Capital strategy
  - Regulatory capital minimums
  - Board-identified capital comfort level
  - Allocation of capital to enhance shareholder value
- Shareholder strategy
  - Public v. private company
  - Subchapter S

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Stock Repurchase Benefits

- Increase ownership percentage
- Increase return on equity
- Increase earnings per share
- Increase cash flow
- No cost to current stockholders
- Sellers receive cash

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Specific Strategies to Address Stock Liquidity

1. Shareholder relations program
2. Holding company share repurchases
3. ESOP/KSOP
4. Market liquidity

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Shareholder Relations Program

- Diminish demand for stock liquidity through shareholder education
- Identify value metrics of stock ownership
  - Earnings per share
  - Return on equity
  - FMV/BV growth
- Active shareholder education on investment value
- Shareholder Relations Officer?

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BHC Share Repurchase

- Voluntary Stock Repurchase
  - Reactive Walk-In Repurchase Program
  - Proactive Voluntary Stock Repurchase Program
- Involuntary Stock Repurchase

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Walk-In Repurchase Program

- Authorized via Board Resolution
- Approve repurchase of specific number of shares at specific price
- Program terms and conditions set by Board of Directors
- Allocate additional capital once depleted

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Voluntary Stock Repurchase Program

- Proactive program open to all or identified stockholders
- Allocation of capital to repurchase of shares at specific amount
- Program documentation
- Program terms and conditions

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Involuntary Share Repurchase

- Forced repurchase of shares
  - Reverse stock split and cash-out of fractional shares
  - Cash-out merger
- Requirement to pay fair value
- Dissenters' rights

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Share Repurchase Price

- Board determination
- No requirement for independent appraisal
- Balance interest of selling and remaining shareholders
- Disclosure requirements

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Funding Share Repurchases

- Existing "excess" capital
- Bank holding company debt
  - Line of credit
  - Secured debt
  - Subordinated Debenture
- Sale of common or preferred stock

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ESOP / KSOP

- Employee Stock Ownership Plan, possibly with a 401(k) feature
- Trust created to own stock for benefit of bank employees
- Funding stock purchases
  - Tax deductible bank contributions
  - Employee 401(k) contributions
  - ESOP leverage

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ESOP Considerations

- Initial formation issues
- Initial and ongoing contributions
- Annual valuations
- ESOP emerging liabilities

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Liquidity Through Public Markets

- Buy/Sell List

  OR

- Pink Market / QB Market

  OR

- OTCQX for banks

  OR

- National exchange, such as the NYSE or the NASDAQ

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We Are In A Consolidating Environment

- Reduced Number of Banks
- Lack of De Novos
- Future of Community Banking

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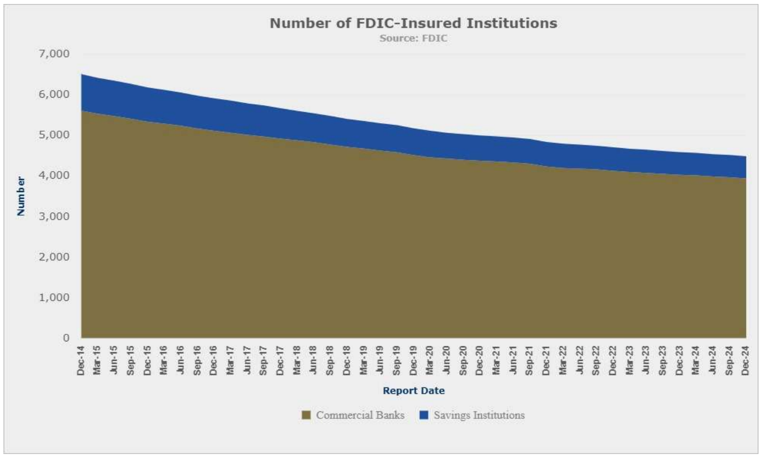
Industry Consolidation



Yearend	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Total	6,509	6,182	5,913	5,670	5,406	5,117	5,002	4,839	4,706	4,587	4,487

* Source: FDIC Quarterly Banking Profile, Fourth Quarter 2024

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Change in Number of Institutions Since 2007

* Through December 31, 2024
** Source: FDIC and S&P Global Market Intelligence

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Current Acquisition Environment

- Continued interest in M&A activity
- Slowdown in deal timeline and announcements
- Practical challenges in today's environment
  - Economic uncertainty
  - Rising interest rates
  - Acquisition Accounting/fair value requirements
  - Data processor contract termination and deconversion fees

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Current Acquisition Environment

- Enhanced regulatory scrutiny
- Changing pricing expectations
- Small bank premiums
- Competition from non-traditional acquirers
- Risk mitigation/due diligence is the name of the game

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Consolidation Drivers

- Troubled Banks – very few, but are more coming?
- Traditional reasons
  - Lack of Succession
    - Management
    - Board
    - Ownership
  - Shareholders/executives that have had all the "fun" they can stand
  - Perceived need for scale
  - Unsolicited offer

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Consolidation Inhibitors

- We don't call them "independent" community banks for nothing
- Current environmental challenges
- Continued increase in interest rates
- The focus on profitability
- If you sell, where do you reinvest the money?

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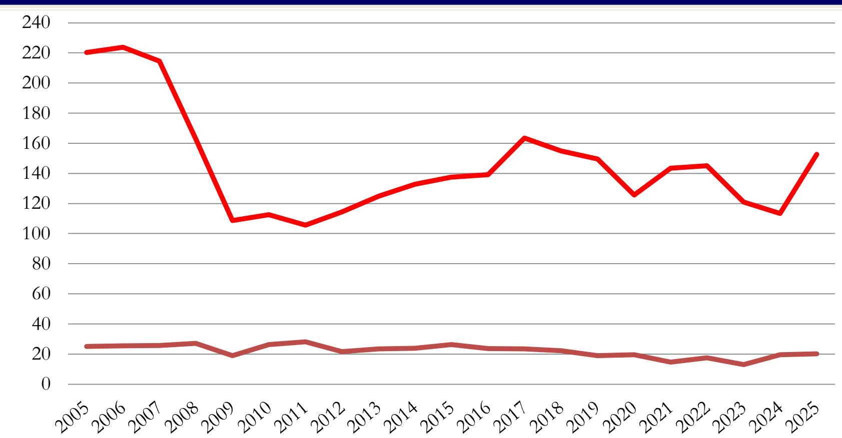
Historical Acquisition Pricing



* Through February 25, 2025
** Source: S&P Global Market Intelligence

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Acquisition Pricing: All Bank and Thrift Transactions

	2022	2023	2024	2025 (YTD)
Number of Deals	171	102	130	16
Average Price/Book (%)	145.02	121.02	113.45	152.70
Average Price/Tangible Book (%)	153.66	127.93	121.28	158.35
Median Price/Earnings (x)	14.37	12.88	16.44	12.47
Average Price/Assets (%)	14.33	10.46	10.59	17.86
Average Price/Deposits (%)	17.32	14.01	13.37	17.38
Median Premium/Core Deposits (%)	6.88	2.53	2.87	10.36

* Through February 25, 2025
** Source: S&P Global Market Intelligence

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The Dilemma

- I want to buy another bank
- I want to position my bank to sell
- I want to remain independent
- I want to do something
- I don't want to do anything
- I have no idea what I want to do

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Asking the Right Strategic Questions

- When are we going to sell the bank?
- Will we ever be required to sell the bank?
- How do we ensure that we don't have to sell the bank?
- What is our antitakeover plan?
- Is buying another bank the best alternative?
- What are my options in lieu of buying another bank?
- How much can we afford and what should we pay?

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The Fundamental Focus

- Enhancing shareholder value
- Can we do a better job in the future?
- Can we grow effectively?
- Can we maintain efficiency?
- How would we view a target and how would we be viewed as a target?

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Strategic Planning for Acquisitions

- Capital is King
  - Stock Offerings
  - Holding Company Leverage
  - Must Find Most Productive Uses
- Internal Growth
  - Greater Volume
  - New Products and Services
  - New Locations

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Strategic Planning for Acquisitions

- External Growth (Geographic Expansion)
  - Proactive or Reactive?
  - What should the footprint look like?
  - Buy another Bank?
  - Buy a Branch?
  - Buy a Non-Bank Company?
- Controlling your own destiny
  - Strategy for addressing unsolicited offers
  - Creative options

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Planning Considerations: The "Buy" Strategy

- Identify the Goals of an Acquisition
  - Advantages
  - Disadvantages
- Define the Characteristics of the Perfect Market
- Consider Capacity
  - Capital
  - Management
  - Board

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Planning Considerations: The "Buy" Strategy

- Scope Out Desirable Markets
  - Competition
  - Market Concentration
- Find Target Institutions within Those Markets
  - Obtain Financials (Asset Quality is Important)
  - Check out Management and Ownership (Subtly)
  - Selling Attributes and Fit (Products and Services, IT, etc.)
  - Create Pro Forma Scenarios

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Planning Considerations: The "Buy" Strategy

- Social Issues
  - Integration of Employees
  - Compensation of Management and Directors
  - Community
  - Location and Name
  - Values versus Culture
- Ascertain Realistic Currency
- Initiate Relationship with Desirable Targets

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Planning Considerations: The "Buy" Strategy

- Analyze Alternative Uses of Capital
  - Share Redemptions
  - Dividends / Distributions
- Branching vs. Acquisitions
- **Will Your Existing Shareholders be Better Off?**
  - Short Run?
  - Long Run?

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Pricing, Negotiation and Structural Considerations

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Basic Currency Considerations

- Cash
- Stock
  - Number of Shares
  - Investment Quality
  - Liquidity
  - Tax Treatment
- Cash and Stock Mix

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Basic Pricing Considerations

- Earnings Driven (Acquiror's Dilution)
- Book Value Dilution Pay Back

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Pricing a Stock Acquisition for Non-Public Companies

- Difficult to Determine Value of Lightly Traded Stocks
- Question of Relative Value
- Determined by Contribution Analysis
  - Income
  - Assets
  - Equity

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Pricing a Cash Acquisition

- Target's After-Tax Earnings
  - \+ or - the After-Tax Benefit or Acquisition Cost
    - Lost Opportunity Income
    - Loan Interest, if any
    - Intangible Asset Amortization, if any
    - Cost Savings
    - Revenue Enhancements
- Net After Tax Post-Acquisition Earnings

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Pricing a Stock Acquisition with Public Acquiror

- Who Bears Market Risk?
  - Fixed Price (Number of Shares Varies)
  - Fixed Number of Shares (Deal Value Varies)
  - Collar and Cuff (Both Vary)
- "Walk" Provisions
- Maximum Number of Shares Acquiror Will Pay

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Maximum Acquisition Price Stock for Stock Transaction

$$\frac{\text{Target's Net (AT) Income}}{\text{Acquiror's Projected Earnings Per Share}} = \text{Maximum Number of Acquiror's Shares}$$

$$\text{Maximum Number of Acquiror's Shares} \times \text{Acquiror's Market Price Per Share} = \text{Maximum, Non-Dilutive Acquisition Price}$$

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- Approach of buyer and seller
- Foot in the door
- Win/win strategy
- Seller/buyer representation
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- Troubled bank acquisitions
- Risk mitigation
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- Non-traditional buyers
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Other Considerations

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  - Employment agreements
  - Noncompetes
  - Voting commitments (board and key stockholders)
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Other Considerations

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- Survival of reps and warranties
- Indemnification
- Stock valuation if a stock deal
- Regulatory issues
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- Reject offer
  - Based on detailed financial and legal analysis
- Accept offer
  - Breach of fiduciary duty if no negotiation
- Negotiate offer
  - Puts bank in play, only if you are serious
- Shop around
  - Only way to determine best price, but time considerations

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Remaining Independent: Community Bank Directors' Conference

Philip K. Smith, Chairman & CEO
Greyson E. Tuck, President
Gerrish Smith Tuck, Consultants and Attorneys

Presented at:
Community Bankers Association of Illinois
Remaining Independent: Community Bank Directors' Conference
Northfield Inn & Conference Center
Springfield, Illinois
April 1, 2025

Community Bankers Association of Illinois
One Mission. Community Banks.

Gerrish Smith Tuck
Consultants and Attorneys
700 Colonial Road, Suite 200
Memphis, Tennessee 38117
Telephone (901) 767-0900
www.gerrish.com

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What Is Succession Planning?

Ensuring Your Organization Has Appropriate Leadership, Management, and Personnel, Now and in the Future.

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Overview

1. Who Are We Planning For?
2. Types of Succession Planning
3. Seven Keys to Effective Succession Planning

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Who Are We Planning For?

- Management & Executive Officers
  - Chief Executive Officer
  - President
  - Chief Financial Officer
  - Chief Credit Officer
  - Chief Lending Officer
  - Chief Technology Officer
  - Other "C-Suite" Positions

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Seven Keys to Effective Management Succession Planning

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#1 – Incorporate Succession Planning Into Strategic Planning

- Effective Strategic Planning
  - Independence as a Preliminary Matter
  - Basic Business Strategy
- Strategic Goals Build Corporate Roadmap
- Talents and Values of Planned Succession Should Align With Strategic Goals

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#2 – Perform Realistic Self-Assessment

- Critically Examine Current Talent, Skillsets, and Values
- Specifically Identify Shortfalls (Threats to Success)
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- Attract and Retain Talent
- Employee Development
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- Approach and Expectations
- Four Fundamental Needs
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Strategies to Attract & Retain Employees

- Employment Agreements
- Equity, Equity-Like or Deferred Compensation
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- Some employees may dislike their plan
- Effective communication is a powerful employee retention tool

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#5 – Ensure Accountability for Plan Achievement

- Create Written Action Plan
  - ➢Specify Task
  - ➢Specify Responsible Party
  - ➢Specify Required Completion Date
  - ➢Follow-Up Process
- Without Accountability, Chances for Success Are Significantly Diminished

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- Succession Planning Must Be Actively Pursued
- Following Seven Steps Will Significantly Increase Chances for Successful Transition

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Consultants and Attorneys
700 Colonial Road, Suite 200
Memphis, Tennessee 38117
Telephone (901) 767-0900
www.gerrish.com

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Remaining Independent: Community Bank Directors' Conference Written Materials

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HANDOUT MATERIALS

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Introduction

I. INTRODUCTION

The community banking industry has undergone a significant amount of change in this century. Since the turn of the millennium, there have been times of economic expansion, economic contraction, a Great Recession, a global pandemic and unprecedented increases in interest rates. In addition, banks have experienced a significant period of consolidation, increased regulation, increased utilization of technology, the proliferation of FinTech companies and other unregulated financial services providers that operate in the shadow banking system, and hyper-inflation and related bank liquidity challenges that seemingly have no end in sight. All of these challenges and changes have made the community banking industry one that is not for the faint of heart. Not only are our smaller institutions forced to comply with a much longer list of regulations and new legislation, but industry analysts and "experts" are still perpetuating the myth that smaller institutions will be unable to survive independently and must seek out a merger or acquisition to achieve economies of scale and compete in the "new normal." To continue to thrive in today's interest rate economy, many community banks are going back to the basics to increase efficiency, reduce costs, and improve overall profitability. In light of all of these issues, community bank boards of directors that desire for their bank to remain independent must understand the importance of planning to enhance shareholder value as the bank transitions into and acclimates to this new environment.

Despite all of the changes, one constant remains for community banks—the board of directors' and senior management's primary obligation to appropriately allocate financial and managerial capital to enhance the value for the bank's or holding company's shareholders. Neglecting this foundational mandate will result in the shareholders looking for an alternative investment and the bank merging out of existence or engaging in an outright sale transaction. It is incumbent upon the board and the senior officers to plan to avoid such results.

The remainder of these materials will hopefully serve as a valuable resource for your community bank's board and management team as they strive to enhance value for the organization's shareholders.

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Plan for It or It Won't Happen

I. A POSITIVE APPROACH TO STRATEGIC PLANNING

A. <u>The Directors' and Officers' Real Job</u>

Directors and senior management of financial institutions have an obligation to enhance shareholder value and to plan for the long term. Hopefully, for most institutions, that means aggressively taking steps to ensure long-term independence and focusing on creating value within the organization. Every institution should at least consider the alternatives of remaining independent for the long term, acquiring another institution or possibly enhancing value through sale. These materials cover long-term planning to enhance value both with and without a sale of the organization.

Today's short-term operating environment for financial institutions, as noted, is still challenging. Therefore, it is imperative that as directors and officers of our community banks, we fully understand the short-term and long-term environmental issues as well as the drivers for long-term success. If our goal is to continue to serve our shareholders and communities, then long-term independence needs to be assured.

This material addresses, from a community bank board and executive management perspective, both short-term and long-term issues, including dealing with the regulators and their enforcement action potential.

To thrive over the long term, our banks must ensure that the shareholders are satisfied. Enhancing shareholder value continues to be of paramount concern. Five critical metrics to determine whether the Board is moving toward enhancing the value for the shareholders over the long term and fulfilling its obligation are set forth as follows:

- Earnings per share growth - 8% to 10% a year. Notwithstanding all the discussion of book value among bankers every time a bank sells, earnings drive value. If the bank can grow its earnings per share by either growing net income or reducing the number of outstanding shares, that will contribute to the enhanced per share value of the organization.

- Return on equity – a range of 10% to 12%. For most community banks, this is merely a "target."

- Liquidity for the shares. We hear often during board meetings about bank liquidity. As directors and officers, we also need to focus on liquidity for our shareholders, particularly as our shareholder base ages. Liquidity in this context is the ability of a shareholder to sell a share of stock at a fair price at the time they want.

- Appropriate cash flow. This means we must address the dividend policy associated with our shares. As the population ages, it is likely their demand for greater cash return on their investments will increase as well. We need to focus on an appropriate dividend policy.

- Safe and sound operations. All of the other metrics will not enhance value for your shareholders long-term if the bank folds due to poor underwriting, risk management, etc. Safety and soundness are critical to protecting your shareholders' investment.

Please consider these and other factors in connection with long-term planning to enhance shareholder value in the current environment.

B. Are You Appropriately Planning for the Future?

As with many issues, it is almost easier to indicate what strategic planning is not than what strategic planning is. Strategic planning is not:

- Budgeting
- A wish list
- A set of unattainable goals
- A broad base set of platitudes
- A document prepared solely for the regulators
- A useless exercise engaged in too often
- An out-of-town trip for the directors

Unfortunately for some banks and bank holding companies, the above words and phrases are an apt description of their annual strategic planning exercise. The strategic planning process and the plan itself should be designed to answer four broad based and basic questions.

1. Who and where are we as an institution?
2. Where do we want to be over the appropriate time horizon?
3. How are we going to get there?
4. Who is responsible for implementing each of the steps?

The strategic plan should provide a broad based road map for where the institution intends to be over a two to three year time horizon. The Board of Directors of the bank or holding company has the responsibility for setting the direction for the company. This includes not only setting financial goals but establishing the culture, providing the long term strategies, identifying the likely means of implementation and following up on the results of the process. Strategic planning provides the "game plan" for the future.

Can a bank operate without a strategic plan? Certainly, and many do. Many $750 million asset banks also operate the same way they did when they were $250 million in total assets. They don't operate optimally, but they do operate. The question is not whether the strategic planning process essential to a community bank's survival. The question is whether the strategic planning process, if properly engaged in, enhances value for a community bank's shareholders through enhancing the value of the company over a longer term time horizon. With strategic planning conducted properly, the answer is yes.

"If you do not know where you are going, any road will take you there." This off quoted phrase is trite but true. The management team for a community bank or bank holding company needs direction. That direction needs to come from the Board of Directors and needs to be in the form of established and specific goals. We "bother" with strategic planning because, when done correctly, it enhances value and preserves independence.

C. The Independence Decision

It is very difficult to establish a strategic plan with any meaningful components if the Board has not made a conceptual determination as to whether it intends to remain independent for at least a two-year time horizon. As noted below, very early on in the strategic planning process generally after the SWOT analysis, the Board needs to determine whether, subject to its fiduciary duty to consider any unsolicited offer, it intends for the institution to remain independent and for how long.

What considerations should go into the independence decision? The overall question is can the bank or holding company make its stock as attractive as an acquiror's stock or cash so that its own shareholders desire to hold its own stock.

During the planning process, the Board must focus on how to make the stock held by its own shareholders attractive enough to continue holding if it wishes to remain independent. As noted above, this involves issues of earnings growth, adequate return on equity, cash flow, and stock liquidity.

Other factors that come into the decision about a sale are identified as "drivers," including aging of the board and shareholder base, lack of management succession, high sale prices, and the like. An additional issue is the potential lack of future acquirors. If the bank has a modestly long term independence goal of, for example, three years, then it needs to specifically analyze what acquirors may be available in three years. Often while meeting with a board in a planning session one year, there may be six acquirors available. Two years later that number may be down to two or three.

In any event, the independence decision needs to be discussed and determined early on in the process. A number of other decisions will flow from it.

D. The "Mechanics" of Strategic Planning

1. Elements of the Strategic Planning Meeting

Each community bank should structure its strategic planning process around the needs of the bank. With that in mind, our general recommendation is that the strategic planning meeting contain the following elements:

a. An introduction as to the purpose and goals of the planning process.

b. A description of the current environment for community institutions and what it means to enhance shareholder value.

c. Analysis and discussion of the independence issue.

d. An identification of substantive issues.

This can be done at the meeting, in advance of the meeting through questionnaires, or in a variety of other ways. It serves as an excellent warm up exercise and helps to identify specific issues particular to the institution that need to be addressed.

e. An independent discussion of each of the issues with a recommendation and plan for addressing each issue.

f. The creation of a mission, vision, and core value statement, if it is appropriate for your bank.

A mission statement is generally a brief statement that sets forth the bank's reason for being, including its operating strategy, philosophy, and purpose with respect to customers, shareholders, employees, and others. The mission statement may sum up in a paragraph or a few short paragraphs what the bank is about.

A vision statement is a statement setting forth the long-term vision for the company as determined by its Board of Directors. The vision statement will allow the officers and employees the benefit of the directors' thought process as to where the company should go.

The core value statement is simply a statement of the core values by which the institution will operate – integrity, timeliness, etc.

In our experience, for about 90% of the community banks in the country, these statements serve no purpose other than to satisfy the regulators. Some discussion at the planning session should deal with whether and how these statements should be used in the future. If the bank's culture is not such that it believes there is any importance to a mission, vision, or value statement, then do not waste your time creating one.

g. A recap establishing specific goals, strategies, timetables, and assignments of responsibility for each issue.

A well thought out and well executed strategic planning meeting does not make for a relaxing day or more. It is generally hard work. Breaks need to be frequent. The facilitator also needs to move the meeting forward toward consensus on issues. Our general recommendation is that the strategic planning meeting last a day or two half days. For the first planning session for a Board of Directors, a day and a half may be appropriate. For a bank that has a planning meeting each year, one day would certainly be sufficient.

2. "Mechanics" of the Plan

The results of the meeting should be the creation of a plan. While our firm strongly believes that a plan should be based on the needs of the bank and not on a checklist of items, strategic plans traditionally have some or all of the following components:

I. Executive Summary

II. Situation Analysis (SWOT)

III. Mission Statement

IV. Objectives

Objectives are the longer term stated intentions of the specific kinds of performance or results that the bank seeks to produce in pursuing its mission.

V. Goals

Goals are the shorter term, quantifiable performance targets desired to be attained as a measurement of performance in meeting each stated objective.

VI. Strategy

A strategy is the blueprint for indicating precisely how to create the performance necessary to attain the stated goals. Strategies define the parameters for all actions to be taken to attain the goals.

VII. Action Plan

The action plan is the set of projects or specific steps to be taken to implement the strategies. Action plans establish responsibilities by area and individuals and establish dates for accomplishment of the plans to implement the strategies.

VIII. Review

This section will indicate how often the Board will review the plan and revise it.

The plan does not need to be long. It does not need to be bound in a "spiffy" notebook. In fact, it does not really matter what it looks like. It simply needs to set forth the relevant issues, such as decisions, goals, and strategies identified by the board, and provide an appropriate level of accountability and follow up, such as assignments of responsibility, a timetable for each of the matters addressed in the retreat, etcetera. Our general recommendation is that the Board of Directors, at its monthly meeting, be provided with a summary checklist of action items that indicates progress on meeting items associated with the plan and determined at the retreat.

3. Financial Issues and Budgets

Although a strategic plan is not a budget, it needs to contain financial goals. These financial goals should be created department by department from the ground up (not dictated from the top down) and incorporated into the plan. A top-down financial plan will result in resentment, a feeling of helplessness and inability to meet goals that are not realistic. The bottom-up budgeting also needs to be reviewed for realism, however.

The plan should set forth in broad terms specific goals in the following areas: return on assets, return on equity, loan growth, deposit growth, dividend growth, and perhaps efficiency ratio.

II. LONG-TERM ENVIRONMENTAL ISSUES TO CONSIDER WHEN PLANNING

The short term environment for community banks has been a challenging one, as noted previously in these materials. As part of the long-term planning process, Boards of Directors and senior officers need to understand whether there is a future for community banks and if so, what does that future hold. The long-term future for community banks should be good, no matter their asset size. Some of the long-term issues that the Board, at the 30,000 foot level, needs to focus on are set forth below.

A. Industry Trends

1. Improved earnings and moderate balance sheet growth.

In the years following the Great Recession, many community banks bolstered profitability by reducing expenses. Although this trend continues for many community banks, community banks have largely focused on core earnings over the past few years and adopted a "back to basics" approach to lending, which has been primarily evidenced by community banks' general focus on profitability rather than balance sheet growth. This position is counter to the stance taken by many community banks prior to the Great Recession, when most institutions believed that size was the key to profitability. While many institutions are seeking to "level off" or even shrink assets in order to focus on core profitability, this trend has shifted over the past few years, and community banks experienced significant asset growth as a result of the Covid-19 global pandemic. As a whole, community banks continue to adopt a "back to basics" mentality, but many banks have become more aggressive in their balance sheet growth strategy. We expect that trend to continue in the near term.

2. Increased focus on other lines of business.

In addition to focusing on improving core earnings and easing back into asset growth, many community banks are re-assessing other lines of business, such as trust departments or insurance agencies, as a means of increasing non-interest income and taking some of the pressure off of interest income in a compressed margin environment.

3. Increased focus on share liquidity.

Additionally, many community banks have heightened their resolve to remain private, locally owned institutions. Because the stock of these privately owned institutions is often illiquid, many community bank holding companies have increased their focus on share liquidity by implementing share repurchase programs as a means of making a market for their own stock.

4. Interest rate risk.

All community banks struggled in large part due to the low rates and compressed margins during the pandemic. Interest rates began to increase beginning in March of 2022 to combat rising inflation and then quickly rose as inflation became harder to tame. As regulators continue to focus heavily on interest rate oversight and risk management, community bank Boards of Directors across the nation are continuing to take a critical look at interest rate risk when planning for the future. The Federal Reserve has continued to advance the ball down the field in the interest of keeping inflation low but that quickly changed as big adjustments were made. While most anticipated that 2024 would see interest rate cuts, the Federal Reserve made three rate cuts over the year, cutting rates by 100 basis points over the year (a 50 basis point cut followed by two 25 basis points cuts). During its last meeting, the Federal Reserve indicated and projected two rate cuts in 2025.With the continued focus on interest rate oversight and risk management, we must be prepared for that interest rate risk as we plan going forward.

5. M&A continues, albeit at a slower pace.

Community banks continue to focus on their role in the current mergers and acquisitions environment. Following Covid-19 and through the first half of 2022, community bank M&A was occurring at a frantic pace. Beginning in 2022, and extending to late 2023, the pace of M&A activity significantly slowed. This was due to a number of factors, most notably the Acquisition Accounting requirements, which require an acquirer to record a target's assets and liabilities at their "fair value" as of the date of acquisition, which is most times significantly lower than the book value, and general economic uncertainty. However, beginning in 2024, there was a renewed sense of interest in M&A. We fully expect this interest to carry through to 2025. Many commentators believe 2025 will be a "breakout year" for M&A activity. We are not quite so optimistic. Many challenges remain to deal completion, including the applicable Acquisition Accounting requirements and depressed pricing when compared to historical levels. We do expect 2025 will bring more M&A deals than 2024. In our view, we see 2026 as the likely "breakout year" for community bank M&A activity.

It is our firm's belief that community banks have and will continue to be a prominent, successful component of the banking industry regardless of size (and regardless of what arbitrary thresholds industry pundits claim). With these trends in mind, however, each community bank's Board of Directors must ultimately make the decision that is in the best interest of the organization's shareholders.

6. Enterprise Risk Management.

In light of the turbulent banking environment, enterprise risk management, or "ERM," has never been more important to community banks. ERM means your bank pays attention to everything impacting its business, especially risk. Put another way, ERM is a holistic, risk-centered approach to managing your organization. Our firms are encouraging every bank to implement a well-documented ERM program. This program needs to be tailored to your institution's size and the complexity of its operations. The regulators do not expect smaller community banks to have the same risk management framework as a multi-billion dollar regional, but they do expect a comprehensive program specific to the bank.

7. Information Technology.

Information technology, along with the associated risks, has also received increased regulatory focus, particularly in light of the continued data breaches that have occurred in the past number of years. Empowerments of fintech companies in the industry, same day ACH payments, screen scrape and mobile access, and general cybersecurity have dramatically shaped and heightened expectations for the nation's small community banks. Although community banks are expected to keep pace with larger organizations when it comes to customer-facing technology, the small banks do not have the robust IT department, expertise, or budget of their larger competitors to ensure all security elements are taken into account and mitigated against. While the regulators have not historically focused on specific technology offerings and elements of a community bank's operations, they have begun to take particular interest in the current environment, especially if a bank experiences a breach or other fraud impacting the security of the bank's systems and confidentiality of customer information. In light of the industry's enhanced focus on information technology issues, long-term information technology planning as a subset of the Board of Directors' overall strategic planning process is a non-negotiable.

8. Financial Capital.

As of January 1, 2015, the Basel III capital framework went into full effect for community banks, and the related capital conservation buffers are now fully phased in. As adopted, the Basel III capital rules remain overly burdensome to community banks, even with the community bank "friendly" carveouts within the regulatory framework. One of the most significant aspects of the Economic Growth, Regulatory Relief and Consumer Protection Act was a mandate to the federal banking regulators to adopt a new "community bank leverage ratio" framework that would establish one ratio (tangible equity capital divided by total average consolidated assets), to be set between 8% and 10%, as an alternative, elective capital framework for community banks. The Community Bank Leverage Ratio ("CBLR") was finally set at 9% in order for an institution to be considered "well-capitalized," with lower thresholds set for purposes of the other Prompt Corrective Action capitalization categories. As a result of Covid-19, the rate was reduced to 8% for 2020, 8.5% for 2021 and returned to 9% in 2022. While Basel III's capital rules do not prevent many community banks from safe, sound, and profitable operation, they are overkill and ignorant of the realities of community bank operations. Thus, for some institutions, the new community bank leverage ratio may be a more beneficial structure.

9. Human Capital.

Succession issues and attracting and retaining quality employees have become critical considerations across the industry. The career path of starting as a teller and rising up through the ranks to CEO are the exception. Competition for quality people is just as intense as competition for loans and other business. Like gaining new business, however, attracting and retaining quality people is more than dollars and cents. Corporate culture and bank stability (which is less predictable in a consolidating industry) are some of the primary considerations for potential hires, which means community banks must be willing to invest more than competitive salary and benefits in its employees.

10. Competition

In the future, it is unlikely that community banks will be "all things to all people." There is simply not enough managerial and financial capital to do so. It is likely that while most community banks will continue to "stick to their knitting," in an attempt to diversify their income stream, some banks will joint venture with insurance, securities, real estate, trust, financial planning and other partners. Most of this will be through third party partnerships or joint ventures and not purchase. There will also be a significant effort continuing in the future to target the unbanked, the Hispanic/Latino population and the elderly.

The types of competitors will also continue to diversify in the future, particularly in the arena of fintech. Notwithstanding the large scale of the mega banks and non-bank financial services (other than retail deposit taking), however, community banks will continue to maintain a distinct advantage within the area of small business lending, agricultural lending and relationship or "high touch" banking. Because of the problems created by the Wall Street banks and the economic recession, and because of the difficulty the large banks will continue to demonstrate in integrating their operations and the constant pressure to centralize operations and decision making for economic reasons, a community bank always will be more nimble, more responsive, more flexible and more creative with its customer base and products and services which will create a continuous competitive advantage long into the years ahead.

11. Ownership will be Important

Over the long term, it is likely that most remaining banks in the United States will be either public companies reporting to the SEC or Subchapter S companies. It is likely in the future there will not be too many bank holding companies "in between." Companies that realize their need to be a public company will become "very public" to generate some market liquidity and access to the public capital markets. Those who qualify or can be made to qualify for Subchapter S will become Subchapter S companies. Currently, approximately one third of the nation's banks are organized as Subchapter S companies. It is likely, as the debate continues regarding the credit unions lack of taxation, that one relief mechanism over the long term will be the continued relaxation of the Subchapter S rules so that more community banks can comfortably elect and operate under Subchapter S. The most recent substantive changes to the Subchapter S eligibility rules came in 2004, though legislation has been introduced in Congress that would further encourage financial institutions to operate as Subchapter S. More recently, in 2017, the Tax Cuts and Jobs Act made more favorable the taxation of income of pass-through entities, such as S corporations, by allowing shareholders to deduct 20% of taxable S corporation income in most circumstances. While the legislation's reduction of the C corporation tax rate initially sparked debate about whether S corporation status is still preferable for tax purposes, it is our firm's belief that S corporation status is still the best means of getting after-tax earnings into the hands of shareholders.

B. Customer/Stockholder Trends

The following major customer/stockholder trends will be apparent over the long term:

1. Less Loyal Shareholder/Customer Base

Technology will continue to dominate. The increased dominance of technology will also play into another trend for the future—less loyal customers.

A number of banks around the country have, in recent years, celebrated their 100th anniversary. When those banks were formed 100 years ago with a few thousand dollars in capital, their local shareholder base was very loyal and exhibited an emotional attachment to that bank and to those shares. As those shares are passed from generation to generation to generation and those generations move away from the location of that bank, the loyalty that once tied that shareholder to that bank begins to dissipate. We will continue to see that trend in the future. This trend of the less loyal shareholder base dictates that the Board and management over the long term focus on enhancing shareholder value since many of these shareholders who no longer have an emotional attachment to the bank's stock will be looking at it simply as a financial investment.

2. Changing Customer Demographics

The "elderly" sector of the population (however that is defined) is a dominant part of today's economy. However, it is no longer the dominant demographic. According to more recent statistics, there are approximately 76 million baby boomers and approximately 83 million millennials, which are those individuals born between the early 1980's and the very early 2000's. These younger consumers are increasingly tech-savvy and educated, and they have a decreased overall reliance on traditional banking solutions. The dominance of the younger generations in the market will continue to increase, as will their need for financial services. A study conducted by the ICBA in recent years indicated that approximately 54 percent of millennials prefer to bank with locally owned and operated community banks. Accordingly, community banks should continue to focus on ways to reach the millennials, and this trend will continue and will require increasing creativity and "out of the box" thinking.

What is the impact on community banks of the changing demographics of the population? The impact is at least fourfold:

- The typical shareholder's investment intent will change from "growth" to "yield."

- The need for products and services to be distributed geographically to theoretically a less mobile, higher aged population will continue, but it will continue alongside a need for increasingly mobile products and services to reach the younger generations.

- Due to technology, all age groups will have better access to information on the bank and its competitors.

- The older generations will likely travel more and have more leisure time and inherently become less loyal customers who need to be tied in with high-quality service and technology. The younger, more entrepreneurial generations, however, will seek out locally owned and operated community banks to meet their banking needs.

3. Ethnic Shift

According to 2020 Census data, the U.S. is projected to become a majority-minority nation for the first time in 2045. While the non-Hispanic white population will remain the largest single group, no group will make up a majority. All in all, minorities—approximately 48 percent of the U.S. population in 2020—are projected to comprise approximately 57 percent of the population in 2060. (Minorities consist of all but the single-race, non-Hispanic white population.) While the total non-Hispanic white population is projected to decline from approximately 199 million to 179 million, the minority population is projected to increase by approximately 77 percent, from 127 million to 225 million over the period.

C. Regulatory Trends

The regulators have been around for a long, long time and will be around long into the future. Although some consolidation of the regulatory system at the federal level has occurred (the OTS merging into the OCC), it is unlikely any further consolidation will occur in the near-term. The Consumer Financial Protection Bureau ("CFPB"), for example, is not going anywhere soon, even if their authority continues to be challenged.

After a tumultuous 2023, which saw the collapse of two banks, federal banking regulators set forth on an ambitious agenda for 2024, including significant proposed changes to capital, resolution planning, consumer compliance, and supervision, among many others. For banks, these supervisory and regulatory changes will further necessitate building and maintaining effective governance, risk management, and control frameworks.

A number of significant proposals were designed to improve the safety and soundness of the banking sector. Among the most significant included the finalization of Basel III international standards, commonly called the "Endgame," as well as new long-term debt requirements for large banking organizations. These regulatory changes will be among the most consequential for the industry in more than a decade, with many smaller banks expected to come under regulatory standards traditionally reserved for the largest, most systematically important institutions. Banks will need to devote significant effort to achieve compliance with these new regulations and understand the impact of these changes to their business model and ability to compete with non-regulated and foreign entities.

Regulatory compliance and the overall regulatory burden remain one of the greatest areas of concern for community bankers. Whereas the regulatory focus used to be safety and soundness, which has improved drastically, the regulatory shift to compliance since the Great Recession has been reemphasized through the regulator's focus on fair lending issues, Bank Secrecy Act violations, CFPB mortgage rulemakings, and unfair, deceptive, and "abusive" acts or core practices. Federal regulators signaled an intention to emphasize consumer protection as part of the 2024 agenda, and such emphasis was seen through results of examinations alleging violations over fees on consumer accounts, fair lending practices, and open banking. In response to these on-going regulatory changes, banks of all sizes will need to conduct a thorough evaluation of their technological usage and partnerships and guard against consumer harm.

Regulatory scrutiny has also extended to bank overdraft practices, insider lending practices, and other various issues related to loan documentation, which have created a sore spot for many bankers as the regulators have begun to criticize practices and policies that have been in place for decades.

Even more troubling, we have also seen instances where the regulators have used the "management" rating within the bank's overall CAMELS rating as a means to send a message when the regulator is simply not happy with something the bank is doing. In other words, if the regulators are critical of something in the bank but cannot formally require the bank take action or cite the bank with a violation, the regulators have begun to reduce the bank's management rating as a catch-all of sorts. While this practice has not become widespread, it does highlight the fact that even in an improved regulatory environment, the results of the turbulent economic crisis are still in the forefront of some regulators' minds.

How the regulators under the new administration address these issues will be important to watch. For additional information on regulatory issues, see the appropriate section of this handout material.

III. HOW TO ENSURE YOUR STRATEGIC PLANNING IS A SUCCESS

Over the years, our firm has compiled a list of "best practices" to help make community bank strategic planning processes as effective as possible.

Make sure the directors and officers "buy-in."

Why in the world would you engage in a planning session for a day or a day and a half or even a minute if, at the end of that planning session, no one has bought into whatever the result is? In this vein, the oddest question we get when we plan to facilitate a planning session is, "We know the directors should attend, but should we invite the senior officers as well?" Our response is generally, and in not such a nice fashion, "Duh!" First, how are you going to get officer buy-in if the officers do not participate in the plan creation? That is not to say the board cannot meet in executive session to deal with board issues, such as board succession, management succession, board size, board meeting and board governance issues. In fact, every planning session we facilitate, we have an executive session with the board. The main session, however, needs to incorporate the senior officer group and the board of directors to determine at a 30,000 foot level the direction of the company.

Second, the reality is that the board's job in planning is to allocate financial and managerial capital. How can the board allocate managerial capital effectively when the managerial capital does not participate in the planning session? For example, if the board decides the bank should, as part of its ongoing strategy, diversify its earnings stream by acquiring other lines of business, such as insurance, and that is the strategy but there is no one in the entire organization that knows anything about insurance (human capital), wouldn't it be nice to know that during the planning session so management can discuss their thoughts on that particular issue?

Include the senior officer team, however that is defined in your bank, in the planning session to make sure, among other things, that the senior officers buy in to the plan and have some enthusiasm toward its implementation.

Make it enjoyable for the participants.

When the Chairman of the Board, or whoever is the lead on the planning process, begins to contact other board members and the board members look for excuses not to attend the planning session, such as "I think I would rather have my annual physical that day than sit through a planning session," then the Chairman knows that this is because the planning session in the past has not been the least bit enjoyable. This reluctance to participate may be due to prior process, content, facilitator or location of the planning session. Make the process enjoyable and worthwhile. Often, this involves getting offsite. It does not have to be a Ritz-Carlton (although that is always nice). Have some social activities or at least a dinner where the board and officers can interact outside the bank and provide for a little "bonding time" over golf, a dinner or something else. If the planning process is not enjoyable, then the group will be reluctant to engage in it the next time because it has been a waste of time for them, or a waste of money, or both.

Do not focus too much on the process itself.

In our firm, we try not to use the term "strategic planning" exclusively. We actually prefer to refer to it as "Action Planning." If your group is going to insist on establishing a certain number of objectives, followed by goals, followed by strategies, and each must have three bullet points under it, etc., then you are focusing way too much on the process. The important thing in Action Planning is to identify the substantive issues, discuss them and establish a plan to address them. The process is, frankly, unimportant.

Spend very little time on the SWOT analysis, then move on.

Virtually every planning session, for a lot of reasons, contains an analysis of the bank's strengths, weaknesses, opportunities and threats ("SWOT"). This is a good exercise to figure out where the bank is at a certain point in time. What are its strengths, what are its weaknesses, what are its opportunities and what are its threats? Our general method is to send a questionnaire out to each of the individuals who will attend the session to confidentially provide us with their written assessment of the SWOT analysis. At the meeting, generally, there is a live SWOT analysis that takes no more than 20 minutes. What is the purpose of that? It gives each of the participants the opportunity to share with their fellow participants, to the extent they desire, their confidential responses. It also gets all of them talking. The purpose of the SWOT analysis is to figure out where the bank is. At the end of the session, the group should return to the SWOT analysis, paying particular attention to the weaknesses and opportunities, to make sure they have been addressed, at least as appropriate, by the plan. Typically, when officers and directors are involved in the planning process, a lot of the SWOT analysis, particularly from the officers, involves operational and tactical issues within the bank, e.g. departmental communication and the like. These are not appropriate for discussion at the board level action planning session but certainly would be fair game for a management tactical and operational planning process.

Encourage the participants to be honest with themselves and each other.

Many of you who are officers and may have grown up on the credit side of the bank realize there are four "C's" of credit. There are also four "C's" of planning. These four "C's" are communication, candor, consensus, and confidentiality. What this all boils down to is that what occurs in the planning session stays in the planning session, but the planning session will be a waste of time if the participants are not honest with themselves and each other. That is difficult. Many boards are populated by directors who have personal agendas and keep their cards fairly "close to the vest." If the bank wants to have an effective planning session, then everybody needs to get their cards on the table so they can be dealt with, particularly if an outside facilitator is present who can take the emotion and the history out of the discussion. Be honest with yourself and others at the planning session and it will be effective (it may be a little painful, but it will be effective).

Do not let one person dominate the meeting.

Many of you have likely been in a planning session where one person dominated the meeting and as a result, the meeting was a total waste of time. That one person, by the way, could be the principal shareholder, could be the patriarch of the bank, could be the matriarch or it could be the facilitator, particularly if you have a facilitator who likes to talk. Don't let one person dominate the meeting. Of the hundreds of planning sessions we have facilitated, there have been several where when an issue has come up or a substantive question, everyone in the room was silent as their heads turned to the end of the table waiting for the dominant player to announce what the bank was going to do. That makes for a very ineffective planning session. No one should dominate the meeting, not the principal shareholder and not the facilitator.

Make it more than a budgeting session.

As noted later in this material, there is a significant difference between long-term strategic planning and operational and tactical planning. Strategic planning is at a 30,000 foot level. Operational and tactical planning is on the ground. Creating a budget is part of operational and tactical planning. Establishing the long-term strategies that will impact dramatically the budget is part of strategic planning. Your strategic planning process is not a budgeting process. Often, when we are working with a new client and ask for a copy of the bank's current strategic plan, what we receive is a budget with a little narrative. The budgeting process and the planning process, while interrelated, are not anywhere near the same. The planning process drives the budget.

Focus on more substantive issues.

The real goal of planning is to focus on the substantive issues, not to have a touchy-feely exercise. If you want to stand in a circle and sing Kumbaya or stand in a circle and fall into each other's arms as a teambuilding exercise, then do it someplace other than the planning session. The planning session is to deal with substantive issues that face the bank and address the strategy for each. These substantive issues, as noted later in this material, fit into categories such as:

- The current environment
- The bank's position on independence
- The overall business strategy for the bank
- How capital is going to be allocated, e.g. buy another bank, redemptions, dividends, distributions, etc.
- What the ownership should look like
- Geographic expansion issues through branching or buying another bank
- Marketing issues, if there are any strategic issues at the board level
- Technology issues
- Other miscellaneous issues

Focus less on the mission, vision, and value statements.

Virtually every bank in the country has a mission statement. That is because even though there is no regulatory requirements for strategic planning unless the bank is subject to an enforcement order, the regulators expect to see some kind of a mission statement. Most of the mission statements for community banks across the nation are interchangeable. They all deal with four topics: shareholders, employees, customers and the community. Often, when we ask in a planning session (always toward the end) if anyone is familiar with the bank's mission statement, 90% of the time we get blank stares or petrified stares that we are going to spend two hours working over a mission statement. The other 10% of the time, we get the comment, "Of course we are. Every decision we make in this bank is driven by the mission statement." Neither one of those is a wrong approach. It just depends on the culture of your bank. Same issue with respect to vision and value statements. Most of the value statements are the same, generally dealing with integrity, preferring the customer, etc. Vision statements, of course, will depend on the bank and often have some vision of expanding geographically and ultimate size goals. There is nothing wrong with any of these statements as long as the bank uses them for something. Our general predisposition is not to spend much, if any, time at all working over these statements. The question is "Based on the plan established, is there any reason to modify the mission statement?" Typically, there is not, but if there is, then generally, the approach would be to assign it to somebody who has attended the meeting to come back with recommendations as to modifications. Don't spend hours and hours wordsmithing a mission/vision/value statement at the planning session. At least, do not do that if you want anybody to come back next year.

Hold everyone accountable and follow up on the actions taken and strategies established.

As noted elsewhere in these materials, every plan and the planning process should result in some action plans as a means to implement the strategies established. If the board spends a day or a day and a half together to determine the strategies for the institution going forward, yet there is no accountability for implementation of those strategies, then that time has been wasted. There needs to be an action plan that involves implementation of the strategies. There also needs to be accountability, and that action plan should be reviewed by the board on at least a quarterly basis to make sure there is some accountability that the actions are actually being taken.

Use an outside facilitator.

Whether the bank uses an outside facilitator is the choice of the board and senior management. The comments we normally get are that it is very difficult for management, or even a board member, to facilitate his or her own retreat simply because there is too much history, emotion, politics, and the like involved. An outside facilitator can at least ask the hard questions. If you are going to use an outside facilitator, try and find one that is knowledgeable about the industry. A number of our clients, before they got to us, have used outside facilitators that are academics or facilitate in other industries. If the bank wants to get the most benefit out of the retreat, then it needs to have an industry expert in community banking facilitate the retreat (and, no, this is not simply shameless self-promotion). A facilitator as an expert in the industry is not coming at the facilitation from an academic perspective, answering questions with no on-the-ground experience. The benefit to the bank of having a facilitator with industry experience is that individual can make suggestions, comment on what other banks have done, and understand the mechanics of how something should take place. If you are going to use an outside facilitator, don't waste your time and money on someone who does not understand the industry.

GERRISH SMITH TUCK
Consultants and Attorneys

Methods to Enhance Shareholder Value Without Buying or Selling

For a community bank or bank holding company, enhancing shareholder value generally means providing some reasonable level of investment liquidity to its shareholders, increasing earnings per share, providing a reasonable return on the investment compared to alternative investments that could be made by the community bank shareholder, and providing some certainty of an adequate cash flow.

The following material will briefly cover several specific strategies for enhancing shareholder value without buying or selling.

I. FORMATION, USE AND CAPITAL PLANNING WITH THE BANK HOLDING COMPANY

Approximately 80% of the community banks in the nation are in a bank holding company structure. All community banks, particularly those under $3 billion in total assets, receive significant benefits from the bank holding company structure. It not only provides flexibility in repurchasing shares and in financing those purchases, but it also provides flexibility in acquisitions, branch expansion, capital raising, new products and services and other means to enhance the value of the overall shareholders' interest.

There are five key advantages of a holding company:

* Improved Capital Planning and Financial Flexibility
* Control and Ownership Planning
* New Products and Investment Opportunities
* Additional Geographic Expansion Techniques
* Enhanced Operational Flexibility

A Bank Holding Company ("BHC") is defined as any company which has control over any bank. In the broadest sense, any corporation or organization that "controls" a bank is a BHC. The Bank Holding Company Act of 1956 ("Act") prohibits any "company" from becoming a BHC without prior approval of the Federal Reserve Board ("FRB").

The Financial Holding Company ("FHC") is defined in GLBA as a BHC that meets the following requirements:

a. All of the depository institution subsidiaries of the BHC are well capitalized;

b. All of the depository institution subsidiaries of the BHC are well-managed; and

c. The BHC has filed the following with the Federal Reserve Board:

    (1) a declaration that the BHC elects to be an FHC in order to engage in activities and acquire shares in companies that were not permissible for a BHC prior to GLBA's enactment; and

(2) a certification that the BHC meets requirements (1) and (2) above.

Bank Holding Companies may borrow money with the debt treated as a liability at the holding company level; however, the funds can be "pushed down" to the bank as new equity capital for the bank. This "double leveraging" technique is most attractive for banks with assets under $3 billion since the bank and the holding company's financial statements are not consolidated for capital purposes by the Federal Reserve. The technique is useful on a more limited basis for those institutions with assets above $3 billion. Dividends from a bank to its holding company are non-taxable, thus the debt is serviced with "before tax" dollars. The BHC and bank file consolidated tax returns, allowing interest on the holding company's debt to be used as a deduction against the bank's earnings.

Through use of the double leveraging technique by the BHC, individual shareholders are not required to provide additional cash to raise capital for the bank. In addition, their ownership percentages are not diluted by a necessary new stock offering to outside shareholders. For small banks, assumption by a BHC of acquisition debt by which the institution was acquired allows the debt to be paid with before tax dollars.

Funds provided by a BHC may be used in many ways, such as:

* Bank Acquisitions
* Non-bank Acquisitions or Activities
* Asset Growth Support
* Replacing Lost Capital
* Restructuring Investment and/or Loan Portfolios
* Providing Liquidity
* Financing Bank Premises or Other Capital Expenditures
* Stock Repurchase Plans
* A General Funding Source

There are also other miscellaneous advantages to a bank holding company in the capital and financial planning area which may be significant for many institutions, such as:

* <u>Alternative equity forms</u>. Since a holding company is simply a state chartered corporation, it can utilize virtually any type of equity structure. For example, it can use preferred stock as well as common stock. It can also use preferred stock with an adjustable rate dividend, or preferred stock convertible into common stock.

  A BHC may also use different classes of stock. For example, if an institution wishes to raise capital but is concerned about diluting the voting control of existing shareholders, a different class of common stock with no right to vote or a smaller percentage vote could be used.

* <u>Debt securities</u>. A holding company may also use various forms of debt. It can use long-term debentures and deduct the interest cost while pushing the money down into the bank as new equity capital. It can issue commercial paper. Short-term or long-term notes or "investment certificates" can be sold by the holding company to existing shareholders, bank customers or smaller

banks, thus eliminating the need to pay a traditional lender a higher interest rate or pay an underwriter a fee for placing the securities. Debt securities with convertibility features allowing the debt to be converted into common stock may also be used. Care must be taken in structuring debt issuances to avoid possible consolidation of bank and bank holding company financial statements for capital adequacy purposes with banks less than $3 billion in total assets.

A BHC can also take existing common stock held by individuals wanting a higher yield than they receive from current dividends and purchase those shares with debentures carrying a higher yield. The additional cost of this type of transaction to the bank may be very limited, since the additional money paid as interest is tax deductible as opposed to non-deductible dividends. Consequently, the IRS "pays" a major share of the cost of debentures while, with dividends, 100% of the cost is paid by the bank.

The key is flexibility. A holding company can issue equity and debt instruments quickly and efficiently. There is normally no need for approval from the primary bank regulators since the securities will be issued by the holding company. Normally, there is no need to get shareholder approval since most original holding company charters already authorize various types of securities. The institution is not limited by what type of capital structure a bank can have since the securities are issued at the holding company level.

Debt issued at the holding company level may be unsecured or secured by pledging the bank stock owned by the holding company. Consequently, a BHC will be able to provide a lender with collateral on a loan to the holding company, whereas, at the bank level, any debt would normally be unsecured and subordinated to the claims of all other credits. Finally, a bank holding company, in certain circumstances, will have more flexibility as to the maturity dates of various debt and equity instruments issued through the holding company.

The other benefits of the use of a holding company, including control and ownership planning, new products, investment opportunities, geographic expansion techniques, and enhanced operational flexibility will be addressed elsewhere in this material.

II. CREATING STOCK LIQUIDITY

Uppermost in the minds of management, directors, and shareholders of most financial institutions today are two fundamental questions:

- Who will control the institution in coming years?
- Can an institution remain independent and provide a market for those wishing to sell?

A. <u>Going public? (Registering with the SEC?)</u>

Liquidity for your shareholders is important. Liquidity must be planned for. "Liquidity" in this context means the ability of a shareholder of your institution to sell a share of stock at a fair price at the time he, she, or it desires. Community banks often wrestle in the strategic planning process as to whether they should become "public companies". The greatest tragedies are those community banks that, with no thought or preparation, inadvertently become public companies by finding themselves with greater than 2,000 shareholders as a result of "death and distribution" or simply sales of minority shares over which they have no control. Many community banks will find the consolidation of ownership is the best way to enhance value. Others will conclude that the expansion of ownership, the creation of liquidity, and the generation of a market for their securities will best serve to enhance value over the long term. Whatever the result, however, the community bank, in order to be effective, must plan for it.

B. <u>Stock Repurchase Plans</u>

For the vast majority of financial institutions in the United States, there are very few acquisitions available, if any, which will improve earnings per share and return on equity more than the simple alternative of repurchasing the institution's own stock. Many institutions are currently realizing that the most efficient deployment of excess capital or leveraging ability is in connection with the repurchase of the institution's own stock. This is particularly true for community banks where such repurchases can generally be accomplished at reasonable prices.

The potential advantages of a stock repurchase or ownership restructuring program are numerous. Earnings per share and return on equity may be immediately increased with a stock repurchase or ownership restructuring program. The relative ownership positions of remaining shareholders will also improve. For shareholders wishing to sell, such plans offer immediate liquidity by providing a purchaser at a fair price, and the shareholders who do not sell become aware that the holding company has the ability to create a market and achieve "psychological" liquidity for their shares. In addition, a repurchase program may also provide a "floor" for the institution's stock that works to enhance shareholder perceptions of bank stock value. Some of the advantages and uses of stock repurchase and ownership restructuring plans are as follows:

* <u>Increased Value</u>. Earnings per share and return on equity may be immediately increased.

* Market Communications. Repurchase plans communicate that management is optimistic about the future and feels the stock is undervalued.

* Takeover Attempts: Keep stock in friendly hands.

* Market Stabilization. Stock repurchases stabilize the market and provide a minimum price for the stock.

* Limit or Reduce Number of Shareholders. Having 2,000 plus shareholders requires bank holding company compliance with federal securities laws including Sarbanes-Oxley. Institutions may use stock repurchases to take the bank holding company private or to keep the number of shareholders below 2,000.

* Consolidate Ownership. Some institutions wish to consolidate ownership around a long-term "core" group of shareholders.

* Forced Sales. Shareholders may be forced to place their stock on the market due to personal financial difficulties, estate taxes, etc.

* Use of Excess Capital. Many banks have excess capital, which can be used to support stock repurchases.

A repurchase by a bank holding company of its own shares at any reasonable price level has the following specific positive impacts on enhancing shareholder value.

* Shareholders who desire to sell receive cash and, thus, instant liquidity for their shares.

* The shareholders who do not sell become aware that the holding company has the ability to create a market and achieve "psychological" liquidity for their shares.

* A stock repurchase plan priced appropriately (and appropriately can mean at a fairly high level) will serve to enhance earnings per share for those shareholders who do not sell and therefore the overall value of the shares.

* A stock repurchase plan, by using excess capital, will increase return on equity for the remaining shareholders.

* Shareholders remaining after the repurchase will experience an increase in ownership percentage of the company without having expended any cash.

* If the company continues to pay cash dividends in the same "gross" amount to a smaller shareholder base, the remaining shareholders will receive an increase in cash flow.

A stock repurchase plan by a bank holding company is one of the few "win/win" strategic alternatives a community board that is not interested in selling in the near term can take.

EXAMPLE OF STOCK REPURCHASE PROGRAM

A. Baseline - no repurchase
B. Repurchase of 316,818 shares funded with $3,485,000 of capital
C. Repurchase of 407,727 shares funded with $3,485,000 and $1,000,000 of debt
D. Repurchase of 498,636 shares funded with $3,485,000 and $2,000,000 of debt

Earnings Per Share (Accretion [+] / Dilution [-])

	Year 1	Year 2	Year 3	Year 4	Year 5
A.	$1.13	$.98	$.98	$.97	$.98
B.	$1.18 (+4%)	$1.04 (+6%)	$1.05 (+7%)	$1.04 (+7%)	$1.03 (+5%)
C.	$1.20 (+6%)	$1.05 (+7%)	$1.06 (+8%)	$1.05 (+8%)	$1.05 (+7%)
D.	$1.22 (+8%)	$1.06 (+8%)	$1.08 (+10%)	$1.07 (+10%)	$1.06 (+8%)

Return on Equity (Accretion [+] / Dilution [-])

	Year 1	Year 2	Year 3	Year 4	Year 5
A.	19.3%	15.6%	14.4%	13.3%	12.6%
B.	22.1% (+15%)	17.6% (+13%)	16.3% (+13%)	14.9% (+12%)	13.8% (+10%)
C.	23.1% (+20%)	18.3% (+17%)	16.9% (+17%)	15.4% (+16%)	14.2% (+13%)
D.	24.3% (+26%)	19.0% (+22%)	17.5% (+22%)	15.9% (+20%)	14.6% (+16%)

Book Value Per Share (Accretion [+] / Dilution [-])

	Year 1	Year 2	Year 3	Year 4	Year 5
A.	$5.84	$6.33	$6.81	$7.28	$7.75
B.	$5.35 (-8%)	$5.89 (-7%)	$6.44 (-5%)	$6.97 (-4%)	$7.51 (-3%)
C.	$5.19 (-11%)	$5.74 (-9%)	$6.30 (-7%)	$6.85 (-6%)	$7.40 (-5%)
D.	$5.02 (-14%)	$5.58 (-12%)	$6.16 (-10%)	$6.73 (-8%)	$7.29 (-6%)

EXAMPLE OF STOCK REPURCHASE PROGRAM
SUMMARY FINANCIAL DATA

EARNINGS PER SHARE

Year	Baseline	Stock Repurchase Price Per Share	
		$148 per share 6,756 shares	$168 per share 5,952 shares
1	$12.09	$13.09 (+8.3%)	$12.69 (+5.0%)
2	$13.08	$14.42 (+10.2%)	$13.98 (+6.9%)
3	$14.16	$15.82 (+11.7%)	$15.35 (+8.4%)
4	$15.27	$17.31 (+13.4%)	$16.78 (+9.9%)
5	$16.45	$18.88 (+14.8%)	$18.30 (+11.2%)

RETURN ON EQUITY

Year	Baseline	Stock Repurchase Price Per Share	
		$148 per share 6,756 shares	$168 per share 5,952 shares
1	8.3%	9.2% (+10.8%)	9.2% (+10.8%)
2	8.3%	9.2% (+10.8%)	9.2% (+10.8%)
3	8.3%	9.2% (+10.8%)	9.2% (+10.8%)
4	8.3%	9.2% (+10.8%)	9.2% (+10.8%)
5	8.2%	9.2% (+12.2%)	9.2% (+12.2%)

BOOK VALUE PER SHARE

Year	Baseline	Stock Repurchase Price Per Share	
		$148 per share 6,756 shares	$168 per share 5,952 shares
1	$145.51	$142.93 (-1.8%)	$138.54 (-4.8%)
2	$157.60	$156.34 (-.8%)	$151.50 (-3.9%)
3	$170.74	$171.15 (+.2%)	$165.86 (-2.9%)
4	$182.25	$187.49 (+2.9%)	$181.63 (-.3%)
5	$200.46	$205.35 (+2.4%)	$198.90 (-.8%)

(%) - % Accretion (+) or Dilution (-) from Baseline

C. Forced Repurchase Transactions

It is also possible to conduct a "forced" stock repurchase, rather than allowing the shareholders to participate in a voluntary repurchase program. There are two basic alternatives for conducting a forced repurchases—a reverse stock split and a discriminatory, or "freeze-out," merger.

1. Reverse Stock Splits.

First, the Company can conduct a reverse stock split and cash out any resulting fractional shares. For example, if the Company wishes to repurchase all shares owned by shareholders with fewer than 50 shares of stock, the Company could conduct a 1 for 50 reverse stock split. This would result in some shareholders owning a fraction of one share, which the Company would cash out under the terms of the stock split.

If the Company wants to avoid the hassle of issuing new stock certificates after the reverse stock split, the Company could subsequently conduct a forward stock split for the same ratio as the reverse stock split. For shareholders who were not cashed out in the transaction, the forward stock split would increase their number of shares owned back to pre-reverse stock split levels.

The process for a reverse stock split starts with the Board determining the appropriate threshold regarding the stock split ratio. As with a voluntary stock repurchase program, this will involve determining the appropriate price per share for the stock and the aggregate amount of capital the Company wishes to allocate to the stock split. The Board must then fashion amendments to the Company's Articles of Incorporation to provide the structure of the stock split and give the Company authority to engage in the transaction.

Amending the Articles is an action requiring shareholder approval, which usually requires a special meeting of the shareholders. To provide notice of the special meeting, the Company will prepare proxy materials to send to the shareholders including the time and place of the meeting, describing the reverse stock split and its terms, and providing a draft form of the amendment to the Company's Articles.

One significant difference when the Company engages in a forced repurchase rather than a voluntary repurchase program is that the shareholders are entitled to "fair value" for their shares. This distinction is significant because shareholders who are forced out have "dissenters' rights" under state law to ensure they receive fair value for their shares. Because the shareholders do not get to elect whether to participate in the program, a simple determination of price per share by the Board is inappropriate. This means the Board should get an appraisal to determine the fair value of the stock, and base the reverse stock split transaction on that price.

State statutes detail the procedure shareholders must follow if they disagree with the Company's valuation of the stock; however, most shareholders do not want to go through the hassle of taking the Company to court to determine fair value. While it is possible a court could find that the Company's determination of fair value is too low, it is also possible the court could find that the Company's determination of value is too high, which would leave the shareholder in a worse position than he or she would have been in simply accepting the Company's initial statement of fair value.

2. "Freeze-out Merger".

The second type of forced repurchase is a discriminatory, or "freeze-out," merger. One of the most common types of freeze-out mergers is reorganization into a Subchapter S structure. Whereas a reverse stock split would simply eliminate stockholders owning less than a certain number of shares, a freeze-out merger would allow the Company to eliminate certain groups of individuals if that were desired (out-of-state stockholders, stockholders holding less than a certain number of shares, or shareholders who do not do business with the organization). Also, and more importantly, a freeze-out merger would ensure that all stockholders are bound by a Stockholders' Agreement, all stockholders agree to sign the IRS Consent, and that the other requirements for Subchapter S are achieved.

The usual structure involves a merger transaction where a phantom corporation is merged into the Company pursuant to the terms of a merger agreement. The general terms of the merger agreement are that any shareholder desiring to remain a shareholder in the Company after it converts to Subchapter S must:

1. Be an eligible Sub S shareholder.
2. Either individually or collectively with their family group own enough shares to be above the cut line.
3. Sign the IRS consent form.
4. Sign the shareholders' agreement.

It is also possible to put other parameters and terms in the merger agreement in the typical case, such as under item #1, the shareholder must be eligible and must be a citizen of the Company's state of incorporation, do business with the bank, or otherwise.

The reason companies do not use the reverse stock split in a Subchapter S conversion is because the reverse stock split does not force the shareholders to sign the IRS consent, be eligible Sub S shareholders, or to sign the shareholders' agreement. The reverse stock split only eliminates the small shareholders. The merger transaction forces the shareholders to comply with these requirements. If they fail to do any one of those things, they get cashed out.

A freeze-out merger requires an approving vote of the Company's shareholders, typically a majority. The Company would prepare proxy materials to send to the shareholders detailing the transaction and providing the time and place of the special meeting at which the shareholders will vote on the transaction. As with a reverse stock split, shareholders to be cashed out have statutory dissenters' rights ensuring they receive fair value for their shares, assuming they follow the statutory procedure to the letter.

III. CONSIDERING OWNERSHIP ALTERNATIVES

Most boards of directors of banks and bank holding companies, both smaller and growing, do not realize that it is within their prerogative and, in fact, their duty, to determine as a long-term strategic decision, the most beneficial ownership for the company and its shareholders. The board has four basic alternatives in this regard.

1. Public company status,
2. Private company,
3. A very private company (Subchapter S)
4. Becoming a public company

Even if the bank holding company is a public company, the board of directors has the strategic decision to make as to whether to take that public company, which is SEC reporting, and make it into a private non-reporting company. The reality is that the board, through its recommendation and voting of its own stock, can, in fact, often control or direct the ownership of the bank or bank holding company and should make a long term strategic decision in this regard which are in the best interests of enhancing value for all shareholders.

A. Becoming a Public Company

As noted above, under the SEC rules and regulations governing public companies, any bank or bank holding company that has in excess of 2,000 shareholders in any class of stock at year-end is a public company and if it is a bank holding company (a state chartered corporation), it must report to the SEC. If it is a bank (not a bank holding company), it must report as a reporting bank to the bank regulators. The reporting requirements for both the SEC and the bank regulators are substantially similar.

Bank holding companies should not become public holding companies without an affirmative long-term strategic decision in that direction by the board of directors. For most community banks, becoming a publicly reporting company will not serve to enhance the liquidity of their shares. The community bank, to effectively create liquidity within the issue of "public versus private", must determine to "go all the way" if it is going to become a public company. "All the way" means significantly expanding the number of shareholders, willingly accepting institutional investors, courting the market makers and generally setting up an investor relations program as described below to generate liquidity and value in the shares.

If your board would like more information regarding the possibility of becoming a publicly-traded company, please contact Gerrish Smith Tuck.

B. Maintain Private Company Status

Most community banks and bank holding companies are private companies with less than 2,000 shareholders. It is imperative, if the board's long-term strategy is to maintain private company status, that it takes affirmative actions necessary to implement that strategy. This generally means keeping a close eye on the shareholder list and, if necessary, engaging in stock repurchases through the holding company in order to keep that shareholder list from getting over the 2,000 share mark. Many community bank holding companies will establish the long-term strategy of consolidation of ownership. From that comes the desire to reduce the outstanding number of shareholders through either repurchase of "walk ins" or affirmative repurchase plans.

C. The Move Toward a Very Private Company Status (Subchapter S)

As noted earlier in these materials, approximately one-third of the banks in existence at are in Subchapter S status. Since the passage of the American Job Creation Act of 2004, Subchapter S now allows 100 shareholders (counting six generations of one family as one shareholder). All shareholders must still be Subchapter S eligible, execute the shareholders' agreement, execute the IRS consent, and hold enough shares to be above the "cut line" to be part of the Subchapter S. In most states, any bank holding company that can obtain the vote of 50% of its shares can convert to a Subchapter S, through a "merger like" transaction.

There are at least three significant issues with respect to Subchapter S.

a. Does the conversion from a C corporation to a Sub S corporation make financial sense for the company in view of the number of shares that may need to be cashed out? In other words, can the company continue to execute on its business plan?

b. Politically, is the forced elimination of certain shareholders for cash (even though the price will be fair) a political risk the Board is willing to accept?

c. Will the remaining Subchapter S shareholders' after-tax cash flow be improved over the long term compared to continuing as a Subchapter C?

Subchapter S is the greatest way to enhance shareholder value currently available to privately held community banks. In its simplest terms, the Sub S corporation eliminates corporate level tax on the bank and holding company such that all income is passed through without tax at the corporate level and for individual shareholders, it appears on their personal tax returns. This is similar to the tax treatment of a partnership. For most community banks and holding companies, the tax savings alone served to significantly enhance the value for their shareholders. This continues to be the case following the Tax Cuts and Jobs Act of 2017. (Even with the reduced income tax rate for C corporations, shareholders of Subchapter S community banks still avoid double taxation of corporate income and receive a boost to after-tax cash flow – not to mention other benefits associated with the Subchapter S structure, including liquidity.) The main caveat is to make sure the bank can provide cash flow through distributions (dividends) to the shareholders to pay the shareholders' personal tax liability.

D. Converting a Public Company to a Private Company

With the advent of Sarbanes-Oxley and its increased emphasis on corporate governance disclosure, rapid reporting and certifications, many smaller community bank holding companies with public company status (greater than 2,000 shareholders) are contemplating returning to private company status. In order to take an SEC reporting holding company to a non-reporting holding company status, it must reduce its existing common shareholders to fewer than 1,200. Many community banks and holding companies automatically found themselves below this increased reregistration threshold as a result of the JOBS Act of 2012. For those banks and holding companies with more than 1,200 shareholders in a class, a shareholder reduction can be accomplished either through a cash-out merger which eliminates the smaller shareholders for cash or a "reclassification" transaction which reclassifies the current common shares held by the smaller shareholders into other classes of common stock. There can be fewer than 2,000 shareholders in those classes. (As noted, under the SEC rule, there can be no more than 2,000 shareholders in any class of stock. Once the common class exceeds 2,000, then to go private, it must be reduced to below 1,200 shareholders.) Any time a bank considers a going-private transaction that either forces shareholders to take cash for their shares or forces shareholders into a separate class of stock, the bank must consider two major issues:

a. Can the bank politically afford to eliminate the shareholders or force them into a separate class of stock? In other words, will it so adversely affect the business relationships at the bank as to be an unwise business decision? This is a question only the board and management, after a thorough analysis of the existing shareholder relations, can answer. Our experience has been that generally, even with the elimination of 500 or 600 shareholders, there is rarely more than a handful of shareholders that, in reality, require personal attention by the board.

b. The second major issue is financial: if the transaction is going to involve a "cash-out", can the company afford to eliminate the shareholders? Fortunately, many bank holding companies have some excess capital, some access to capital, or some borrowing ability that will allow them to finance the elimination of the shareholders through debt. If it is to be a cash-out transaction, it is important to run the numbers after determining that the political issues are manageable to see if the transaction is financially acceptable from a business standpoint. Normally, the freeze out of minority shareholders, which is tantamount to a redemption or a repurchase by the holding company, benefits significantly those shareholders who do not have to sell from an earnings per share accretion, return on equity accretion, and cash flow (dividend) accretion with respect to the stock.

If the transaction is to be structured as a stock reclassification where very few shareholders are to be eliminated, then the financial and political issues are significantly diminished.

IV. ALTERNATIVE LINES OF BUSINESS

In order to assure income growth and de-risk the income stream, it is essential for the bank to focus on alternative lines of business. The most likely lines of business to be offered by community banks across the nation will be insurance, securities, trust, wealth management, and ultimately real estate brokerage, when it becomes available. The key factor is to understand what the bank and/or its holding company can do and what fits with the market niche the bank plans to develop or what the existing customers want.

In 1999, the Gramm-Leach-Bliley Modernization Act (GLBA), which greatly expanded new product and investment opportunities for financial institutions, was enacted. As a result, a financial institution may choose from a variety of structures and entities in order to pursue new product and investment opportunities. These entities include:

* financial holding companies (FHC),
* traditional bank holding companies (BHC),
* bank financial subsidiaries (FS),
* bank operating subsidiaries (OS), and
* bank service corporations (BSC).

This material will focus on using the FHC and BHC for product and service expansion.

A. Financial Holding Companies

The most flexible entity for a financial institution to use to engage in new types of financial activity is the financial holding company (FHC), which allows new activities to be conducted through a holding company affiliate regulated by the Federal Reserve Board. As noted earlier in this material, an FHC is simply a traditional BHC that satisfies, and continues to satisfy, certain regulatory requirements. A BHC that satisfies these new requirements may elect to become an FHC to engage in the broad range of financial activities permitted under GLBA. However, a BHC may elect not to become a FHC if it wants to only engage in the types of activities in which a BHC were permitted to engage in as of the day before GLBA's enactment. In addition, the FHC is the primary entity through which a non-banking financial institution (e.g. a securities or insurance company) may purchase a bank.

Financial Activities. An FHC may engage in any type of financial activity that was permissible for a BHC to engage in before the enactment of GLBA. In addition, an FHC may engage in virtually any type of financial activity. An FHC may even be authorized to engage in certain non-financial activities under limited circumstances. GLBA provides a detailed list of new activities that are permissible for an FHC. The most important of these activities include:

- All securities underwriting and dealing activities,
- All insurance underwriting and sales activities,
- Merchant banking and equity investment activities,

- Future (financial in nature) and incidental activities, and
- "Complementary" non-financial activities.

B. Traditional Bank Holding Companies

Permissible "Non-Banking" Activities. GLBA amended Section 4(c)(8) of the Bank Holding Company Act of 1956 (12 USC §1843(c)(8)) to permit BHCs to invest in shares of any company, the activities of which had been determined by the Board by regulation or order as of the day before GLBA's enactment, to be so clearly related to banking as to be a proper incident thereto, subject to such terms and conditions contained in the regulation or order unless modified by the Board. The Federal Reserve Board has compiled a list of permissible activities for BHCs in Regulation Y, including:

- Acting as an insurance agent or broker for certain types of insurance
- Underwriting credit insurance directly related to credit extended by the bank holding company or its subsidiaries
- Making or acquiring loans, issuing letters of credit, and operating mortgage banking, finance, credit cards and factoring operations
- Leasing personal and real property
- Appraising real estate for a fee
- Providing data processing services
- Selling money orders and travelers checks
- Servicing loans
- Providing management consulting advice to non-affiliated financial institutions
- Operating various types of industrial banks
- Acting an as investment or financial advisor
- Providing securities brokerage services
- Investing in community welfare projects
- Performing trust company services
- Check guaranty services

Passive Investment Alternatives. There are investment possibilities at the BHC level which may not be available at the bank level. The types of equity securities held by a bank are severely restricted as a result of amendments by the FDIC Improvement Act (FDICIA) to Section 24 of the Federal Deposit Insurance Act. A BHC, however, may own shares of any company as long as it owns no more than 5% of the outstanding voting shares. It may own a higher percentage of the equity than 5%, but that interest must be non-voting stock.

Stake Outs. Some financial institutions structure what is called a "stake out" to invest in banks or prohibited businesses. This is an alternative investment method not only for geographic expansion into prohibited areas, but also for expansion by a BHC into a prohibited industry. Specific guidelines adopted by the Federal Reserve Board limit and monitor this type of transaction. These guidelines were developed with the acquisition of equity interests by out-of-state companies prior to the advent of interstate banking.

V. ATTRACTING AND RETAINING HUMAN CAPITAL

A critical key for the directors is to make sure that the company can not only attract but retain quality and key employees. Generally, this means that corporate culture and employee compensation and benefits must be comparable to what an employee could obtain elsewhere.

Providing appropriate incentives for officers, directors and employees can often serve as a means whereby shareholder value is enhanced. It creates an incentive for individuals managing and operating the bank to insure that the bank operates profitably. It also gives those individuals a share in the increased profitability and productivity which they have created. Five major ownership incentives are used in a typical community bank and are fairly easy to implement. These include the employee stock ownership plan (ESOP), the incentive stock option plan (ISOP), stock appreciation rights plan (SAR), non-qualified stock option plans and restricted stock plans. Each of these is briefly addressed below.

A. <u>Employee Stock Ownership Plan (ESOP)</u>

An ESOP is a means for a community bank to create liquidity as well as establish an employee benefit for the Bank's officers and employees. The definitions for Employee Stock Ownership Plans (ESOPs) include:

- qualified retirement plan and trust,
- defined contribution plan,
- stock bonus plan,
- deferred compensation fringe benefit plan, and
- a financing vehicle or strategy.

The basic rules of operation of an ESOP are identical to other qualified retirement plans, including stock bonus plans, profit sharing plans, or defined benefit pension plans. The ESOP must be operated for the exclusive benefit of employees and must not discriminate in favor of the highly compensated and others in the prohibited group including officers, directors and shareholders. The ESOP differs from other plans in that the primary investment of the ESOP must be employer stock.

The use of ESOPs for Subchapter S holding companies or banks, 401(k) ESOPs or leveraged ESOPs have additional operational requirements and offer additional benefits for employers and employees. *For additional information, please request Gerrish Smith Tuck material entitled "Utilization of Employee Stock Ownership Plans."*

B. <u>Incentive Stock Option Plan (ISOP)</u>

The ISOP is the term used for qualified stock options that do not result in a tax consequence when the option is granted or when it is exercised. (However, the amount that the fair market value of the stock exceeds the option price is a tax preference item used in the computation of the alternative minimum tax in the year the ISO is exercised.)

If the employee holds the stock for two years from the date the option is granted and one year after he receives the stock, the employee's taxable gain on the sale of the stock will be entitled to capital gains treatment. If the stock is sold before these periods end, the employee has ordinary income. The employer will be entitled to a deduction only if the employee pays ordinary income on his gain. Under current tax laws, capital gains are preferable to ordinary income for many taxpayers; therefore, ISOPs have become preferable to Non-qualified Stock Option Plans (which can result in ordinary income to the option holder).

Generally, establishing an ISOP requires that the written plan must be approved by the shareholders, options must be granted within 10 years after the plan is adopted, and options must be exercised by the employee within 10 years after the grant of the option. The option price must not be less than fair market value at the time it is granted (a good faith attempt to establish value must be shown). Additional requirements include:

- The option must be non-transferable except by death and can be exercised only by the employee.

- The employee, at the time the option is granted, must not own more than 10% of the employer's stock. (This is waived if the option price is 110% of fair market value and requires exercise in 5 years.)

- An option can't be exercised if an earlier ISO granted to the employee is outstanding. (Earlier options can't be cancelled.)

- The value of the stock that can be exercised for the first time by an employee in any one year cannot exceed $100,000, based on the fair market value of the stock at the date of grant of the option.

- A special IRS ruling provides that employees may exercise ISO's with other non-qualified stock options of the corporation and not affect that $100,000 limit above. (Of course, the employee will be taxed on the non-qualified stock options.)

If all requirements are satisfied, incentive stock options are excluded from compliance with IRC Section 409A requirements for defined compensation type plans.

C. <u>The Stock Appreciation Rights Plan (SAR)</u>

Generally, a SAR Plan entitles an employee to the appreciation in value of the employer's shares held in the employees account over a period of time. At the time of exercise, the employee will receive cash based on the increase in fair market value of the employer's stock from the date the SAR is granted to the date the SAR is exercised.

The key factor is the valuation. Fair market value of one share of stock is usually the value relied on, but the method of establishing the value could be based on book value or otherwise and should be set forth in the SAR plan. In either case, employees' units typically increase in value by (1) appreciation in BHC stock or (2) dividends paid on BHC stock.

Employees receive no vote or ownership rights with units assigned. Employees can receive cash from the Company in exchange for their SAR unit value five years or later from the date the units are awarded or when an employee becomes disabled or dies, whichever comes earlier. The plan may provide that the employee has the option to cash-in his SAR rights after five years or that the employee is required to cash in after five years. If the employee has the option to cash in the SAR after five years and does not exercise the option, the account will continue to grow.

The tax consequences to the employee are:

1) The employee recognizes no taxable income at the time a unit is awarded to his account or as his account grows, and

2) At the time of payment of cash benefits to the employee, he recognizes ordinary income for tax purposes on the amounts received.

The tax consequences to Bank are:

1) Bank gets no deduction at the time the unit is awarded to the employee, and

2) At the time cash is paid to the employee, the Bank can deduct these payments provided the payments under the plan are reasonable enough to be considered ordinary and necessary business expenses.

There is no specific Internal Revenue Code provision authorizing the Stock Appreciation Rights Plan. There are a number of IRS private letter rulings and Revenue Rulings regarding SARs. SARs are excepted from the compliance requirements of IRC Section 409A for deferred compensation type plans if (a) the SAR payment is not greater than the excess of the fair market value of the stock (disregarding any lapse restrictions) on the date of exercise over the fair market value on the date of grant of a fixed number of shares at that time, and (b) the SAR may not include any feature that delays income inclusion beyond the exercise of the SAR.

D. <u>Combination Incentive Stock Option Plan (ISOP) and Stock Appreciation Rights Plan (SAR)</u>

A disadvantage of the ISOP is that in the year the employee exercises the option, he must do so with his own funds or borrowed funds unless the employer pays a bonus to the employee in that year.

For this reason, ISOPs and SARs are often used as a combination. The SAR is granted and timed so that the employee can cash in his SAR units in the same year that he will need cash to fund the purchase of stock pursuant to an ISOP. When this occurs, the employer will have a tax deduction in the amount paid for the SAR, and the employee will have taxable ordinary income in this amount. Payment of the funds to the employer for the stock received by the exercise of the ISO will not result in a deduction for the employer or in income to the employee (unless there are alternative minimum tax considerations). From a cash flow standpoint, the employer may have paid out the same amount for the SAR that it will receive for the stock, so the transactions are a wash to the employer. That transaction would also be a wash to the employee from a cash flow standpoint, but the employee will receive new stock (with a basis of the cost of the stock) and will owe tax on the SAR amount.

The IRS has ruled that tandem ISOPs and SARs are permitted if:

(1) The SAR expires no later than the ISO.

(2) The SAR does not exceed 100% of the difference between the market price of the stock and exercise price of the ISO.

(3) The SAR has the same restrictions on transferability that are on the ISO.

(4) The SAR may be exercised only with the ISO.

The SAR can be exercised only when the market price of the stock exceeds the exercise price of the ISO.

E. Non-Qualified Stock Options

Non-qualified stock options are often granted to community bank directors at the same time ISOP's are established for officers and employees. If the non-qualified stock options have a value at the time they are granted, such options are taxable to the employee or director in the year the option is granted to them, unless the option is non-transferable. If it is non-transferable, no tax is due until the exercise of the option. A non-qualified stock option must have the fair market value of the stock at the time of grant as the exercise price and have no other provisions that delay the recognition of income when the operation is exercised, in order to avoid compliance with IRC Section 409A requirements for deferred compensation type plans. When the option is exercised, the employee or director will have taxable ordinary income on the difference between fair market value of the stock at the time of the exercise and the option exercise price. The employer will have a deduction in the same amount.

The non-qualified stock option may contain any of the features required for an incentive stock option plan, but none of those are mandatory. The non-qualified stock option can be used in tandem with the Incentive Stock Option Plan (to exceed the $100,000 annual limit) and with the Stock Appreciation Rights Plan.

F. Restricted Stock

Restricted Stock Plans generally grant stock to executives with certain restrictions. The restrictions may be that certain financial goals must be met before the restrictions lapse or that the executive must continue to be employed for a certain number of years or both. If the conditions associated with the restrictions are not met, the stock is forfeited.

Restricted stock may have favorable tax benefits in that the executive is not required to recognize ordinary income for tax purposes when the restricted stock is issued. Assuming that the restriction constitutes a "substantial risk of forfeiture", the executive will not be required to recognize income under IRC Section 83 until the restriction lapses. The executive will be taxed on the entire value of the stock when the restrictions lapse and the conditions are met, however, which could impose an extreme cash flow hardship if the executive does not want to sell his stock at that time.

If, instead, the executive makes an "83(b) election" as authorized under the Internal Revenue Code, he would have to include in his income for the year of receipt the value of the stock on the date it is granted. The executive would then be able to defer recognition of the increase in the stock's value until the stock is sold, which might be 10 or 15 years later. Additionally, the amount deferred would be taxed at capital gains rates.

A Section 83(b) election is generally unattractive when the amount of taxable income immediately recognized (due to a high stock price) is very high. However, if the current price of the stock was low and substantial appreciation was anticipated, a Section 83(b) election would probably be advisable, since it would be made at a low present tax cost with a possibility of significant tax deferral. Also, the granting of the restricted stock could be spread over a period of years to lessen the tax effect of the 83(b) elections. Granting of the restricted stock can be linked to bonuses that help to pay the tax obligation imposed if the 83(b) election is made.

Another alternative would be for the company to sell the restricted stock to the executive for fair market value, so that a Section 83(b) election could be made at no current tax cost. The bank could loan to the employee part or all of the funds required to purchase the stock, subject to the limitations under Part 215 of the FDIC Regulations entitled "Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks" (Regulation O). The loan could be made repayable immediately, if the executive left the bank's employment. A part of the executive's bonus each year can be designated to retire the loan.

It is also worth noting that the Tax Cuts and Jobs Act of 2017 created a new Section 83(i) election that would permit certain employees to spread out tax liability associated with restricted stock over a period of five years. This section, however, has certain requirements that make it highly unlikely to be utilized by community bank employees for incentive purposes.

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Restricted Stock v. Stock Options			
	Restricted Stock	**ISOs**	**NSOs**
Can employees receive capital gains tax treatment?	Yes, any gain over price at date of grant is taxed as capital gain if an 83(b) election is made.	Yes, any gain on shares received on exercise is taxed as capital gain, provided holding period rules are met.	Only for gains on shares held after exercise.
Is employee taxed at grant?	No, unless employee makes 83(b) election; otherwise, ordinary income tax paid when restrictions lapse.	No.	No.
Is employee taxed at vesting?	Yes, unless employee made an 83(b) election at grant.	No.	No.
Is employee taxed at exercise?	N/A	No.	Yes.
Can tax be deferred until sale?	Yes, if 83(b) election made at grant, capital gain can be deferred.	Yes, if requirements met.	No.
Can Alternative Minimum Tax apply?	No.	Yes, to spread on exercise if shares not sold in year of exercise.	No.
Does the employer get a deduction?	Yes, for amount recognized as regular income to employee.	Only for disqualifying dispositions for amounts taxed as ordinary income.	Yes, for amount recognized as regular income to employee.
Does the employee get dividends?	Can be attached to restricted shares before restrictions lapse.	Not until shares are actually purchased.	Not until shares are actually purchased.
Are there voting rights for employees?	Can be attached to restricted shares before restrictions lapse.	No.	No.
Is there value if the share price goes down below grant price?	Yes.	No.	No.
Do the awards affect dilution and EPS calculations?	Yes, but normally fewer restricted shares are issued than options because of their downside protection.	Yes, even if the awards are underwater.	Yes, even if the awards are underwater.
Can employees delay exercise after vesting?	No, shares belong to employee when restrictions lapse.	Yes, usually for several years.	Yes, usually for several years.
How is value affected by decrease in stock value below date of grant value?	Value of stock decreases, but not worthless.	Worthless.	Worthless.
Does the employer recognize an expense in its income statement?	Yes, in an amount equal to the fair value of the stock at grant.	Yes, in an amount equal to the fair value of the stock at grant.	Yes, in an amount equal to the fair value of the stock at grant.
How is the compensation expense recognized?	Accrued on the vesting or performance period.	Accrued on the vesting or performance period.	Accrued on the vesting or performance period.
Can the employer reverse compensation expenses for forfeited awards?	Yes, for forfeited awards with “service” or “performance vesting”.	Yes, for forfeited awards with “service” or “performance vesting”.	Yes, for forfeited awards with “service” or “performance vesting”.

VI. GET THE RIGHT BOARD

Often, the directors neglect to "focus on themselves". If the goal and purpose of the Board of Directors is to direct the institution, then the Board must focus on numerous critical areas of its own existence. Below are a number of matters the Board should consider to ensure appropriate oversight.

A. Board Composition

1. Size

When it comes to matters of board composition, one of the first issues is the appropriate size of the board—that is, the number of directors serving on the board. Most charters for banks and bank holding companies provide a range for the size of the board of directors, e.g. 5 to 25. The board simply needs to decide what its most effective operating group is. Once that is decided, the board will recognize whether there are board succession issues or board attrition issues which need to be addressed. In other words, do we need to add directors or get rid of some of the existing directors?

2. Director Qualifications

Often board members are required to have one or more general qualifications in order to serve on the board. These would include living in the community, minimum stock ownership, active trade or business in the area, and the like.

In addition to general qualifications, what specific skill sets does the board require when a vacancy exists? In other words, do you need an accountant? A lawyer? An individual with real estate experience? These considerations are very important depending on your current board's expertise and the needs of the bank at the time of the vacancy.

Competent board members are a necessary ingredient for success in community banking. The board should seek out and promote directors who understand the business values and competitive environment of a community financial institution. Board members who understand these factors are an asset to the organization. Board members who do not understand these factors are a liability. New board members should understand the values, culture and competitive environment of the bank. Only when all board members understand each factor will the board be able to perform at its optimum level.

3. Diversity

A community bank board of directors has traditionally been composed of white males ranging from the ages of 50 to 75. While there is certainly nothing wrong with the traditional community bank board, it may not fulfill the needs of the modern community bank. Directors with different business and cultural backgrounds may provide the diversity needed for success in today's competitive environment. Each institution should consider the composition of its board and determine whether the board members allow for optimum board leadership.

4. Continuing Education

Community banking is constantly evolving. The thoughts and strategies of five years ago may not be applicable to today's banking environment. The Board must have opportunities to increase its collective knowledge of the community banking industry. Most often this is accomplished through directors attending director's conferences or workshops. However, director education should not be limited to these special events. Board education can come through a number of avenues, most notably distribution of current literature about community banking. There are a number of educational opportunities for board members, and the Board should to take advantage of each of them.

B. Directors' Meetings

1. Create Agenda for Meeting

Many boards use the same agenda they have used for their board meetings for the last 20 years or however long they have been open. It is rare that any director questions why an item is included in or excluded from the agenda. The agenda is often used simply because "that is the way it has always been done around here". We suggest you take a fresh look at the agenda.

An effective board agenda will move the meeting along toward resolution. It is usually the role of the Chairman to determine which issues need to be discussed and in what order they will be presented. At the meeting, the Board must take the time to address all issues that need to be addressed and then must provide direction for the bank.

Items on the agenda, of course, include financial reports, loan reports, regulatory reports, reports on issues relating to shareholders and many others. It is often good for a board, from an agenda standpoint, also to provide some time, whether during each monthly board meeting or quarterly, for some strategic thinking or review of the strategic plan.

It is also our firms' general recommendation for community bank boards to utilize consent agendas for their meetings. In short, a Consent Agenda contains all items of general agreement (such as prior meeting minutes, staff appointments, and general correspondence) and groups them into one item on the agenda to be confirmed. Information in the consent agenda would be distributed beforehand as part of the board book (discussed below), and, unless items are removed at the request of a director, the consent agenda would be adopted at the meeting without discussion. *For additional information on consent agendas, please request Gerrish Smith Tuck Clients & Friends Memorandum regarding Efficient Conduct of Board Meetings.*

2. An Effective Board Book

The board must also have appropriate access to information regarding issues to be discussed at the meeting. There should not be "too much" or "too little" information provided, and it is important the information be delivered well in advance of the meeting so the board can review the information and act intelligently on the action items required. It is critical that directors have the time to understand and consider the issues facing the bank. The definition of "well in advance" may be different for each institution, but probably means at least three days. The board should also decide whether the information will be available electronically or in hard copy. The bottom line is that the board needs to get the information delivered in an efficient manner and take the time to review it prior to the meeting. This should significantly reduce meeting time and allow the board to focus on the important issues, not "all" issues.

3. The Tone of the Meeting

All boards are different. Some are passive, some are contentious, some are a mix. In all cases, the tone of the meeting should allow for effective decision-making and debate. It falls to the Chairman as leader of the Board to determine the most effective means to run the board meeting, but all directors should take matters seriously in order to fulfil its role. One Chairman may set the tone by holding tight reins over the board. Another Chairman may set the tone by providing more flexibility and allowing discussions, subject to being brought back for a vote. The goal is to have an effective operating and decision-making board. Whatever tone accomplishes this is up to the individuals involved.

4. Active Board Involvement

An involved board has the greatest chance to be a successful board. Board members should attend and stay active and engaged throughout board meetings, and all directors should strive and be encouraged to actively participate in all board discussions and be proactive rather than reactive in their duties.

5. Executive Sessions

A good corporate governance practice is to call the Board into executive session on some periodic basis. An executive session is simply a session of the board of directors without the chief executive officer or other inside directors. Under Sarbanes-Oxley, for public companies, particularly those that are listed on an exchange, an executive session on a "regular basis" is required. We interpret "regular basis" to be quarterly.

Good corporate governance has legitimized the executive session of the board. Prior to the corporate governance requirements after Sarbanes-Oxley, executive sessions were only held when the bank was making a change in the management. These were often secret meetings at the Chairman's house. This is no longer the case. Today the executive session is seen as a legitimate part of effective corporate governance. Done right, executive sessions should eliminate the need for "parking lot" meetings and give every director the opportunity to discuss any issues on his or her mind without the presence of management.

If the Board elects to hold executive sessions, it is the Chairman's responsibility to designate a minute taker. This is on the theory that what is not documented has not occurred for regulatory purposes. After each executive session, the Chairman or the lead director should also discuss with the chief executive officer the general results of the executive session. This is designed to reduce the CEO's anxiety over the executive sessions.

C. Board Evaluation

Each board should consider establishing a board evaluation system and provide for the evaluation of senior management. The best prevailing best practice would be for the board to be reviewed at least annually. This may be in the form of a self-evaluation or an outside evaluation. These evaluations promote effective corporate governance by allowing the board to identify its own strengths and weaknesses. A board with knowledge of its strengths can capitalize on these for the benefit of shareholders. More importantly, however, is a board being aware of its weaknesses. A board with this knowledge can devote time and energy to improve on these for the benefit of shareholders.

In evaluating the board of directors, the primary focus is on group performance. A focus on individual performance is appropriate, but the main focus should be on the group's strengths and weaknesses as a whole. The evaluation should also consider whether the board is meeting its goals. If goals are not being met, the evaluation should identify why these goals have not been met and should outline steps the board will take to improve its chances of meeting them in the future.

In addition to considering board evaluation, the board should ensure management is evaluated. In many community banks, no CEO evaluation (at least on a formal basis) is ever conducted. Many CEOs indicate they assume they are doing a good job because the board continues to give them a raise but provides little, if any other, feedback. Often, CEO evaluations are difficult because the board members are evaluating a friend, protégé, etc. Notwithstanding the difficulty, the Chairman's obligation is, in part, to make sure that management, as well as the board, is evaluated.

D. Committee Appointments, Responsibilities, and Functions

The board should also establish committees and populate those committees with appropriate directors. To do this, the board should evaluate the needs of the bank and determine which committees will best fulfill those needs. Once the committees are determined, the board should identify the purpose and goal of each committee and how its success is to be judged. Committee members must understand their expectations and should be given a set of obtainable goals. Further, the board should see to it the committee is comprised of board members that will most effectively fulfill the role of the committee. Finally, the board should review the committees at least annually to ensure they are functioning as desired and fulfilling the needs of the bank.

E. Corporate Governance

Whether a company reports to the SEC and is subject to Sarbanes-Oxley or is a private bank or bank holding company—or even a Subchapter S—the board has the duty to make sure appropriate corporate governance is implemented. For public companies, the corporate governance roadmap is established by Sarbanes-Oxley. For private companies, the best practices in corporate governance must be weighed against the costs of implementing such best practices. It would be foolish for a private bank holding company that did not have to comply with Sarbanes-Oxley to spend the hundreds of thousands of dollars necessary in corporate governance simply to establish "best practices" that were not required. The board of a non-public community bank holding company must weigh the costs versus the benefit of "best practices" in corporate governance. It is the board's responsibility to establish appropriate corporate governance for the bank and holding company, which often requires the board to work closely with the bank's outside counsel or consultant.

F. Confidentiality

Nothing can ruin the reputation of a bank and holding company faster than confidential information leaking like a sieve out of the board of directors. Most boards have had board members who, for whatever reason, have deemed it appropriate to discuss bank business (including borrower business) at the country club after a few too many drinks, at the coffee shop, or otherwise in the community. It is the Chairman's obligation to instruct the board on confidentiality issues, and to address leaks associated with confidentiality. It is the fiduciary responsibility of each director, however, to maintain information provided as confidential.

G. Conflicts of Interest

Each director on the board owes his or her bank a duty of loyalty. The duty of loyalty requires the directors to refrain from placing their personal interests before the interests of the bank. Like revealing confidences, a breach of the duty of loyalty will present a number of legal, ethical and professional problems.

VII. ENGAGE IN SUCCESSION PLANNING

One non-negotiable, but often overlooked, aspect of enhancing shareholder value is ensuring that the institution attracts and retains human capital by incorporating short-term and long-term succession plans into its overall strategic planning process. Particularly in a troubled banking environment, the need for a qualified board of directors and management team is essential to an institution's success. Understandably, planning for a multitude of possible scenarios is not the bright spot on the Board's agenda. Nevertheless, ensuring the future value of the institution's shareholders requires that these possibilities be addressed. Drafting a plan may be a hassle now, but it will help ensure that productivity and institutional culture remain intact when inevitable change occurs.

A. Part of Strategic Planning

For every institution, the first step of a successful succession plan is engaging in strategic planning and identifying its goals and strategies for the future. What are the institution's capital goals? How does it plan to implement new technologies? Does it intend to grow organically or through a merger or acquisition transaction? The institution has to know where it wants to go before it can plan on how to get there.

Bear in mind that just as a strategic plan needs to address short-term and long-term goals, effective succession planning identifies and plans for the institution's short-term and long-term managerial needs. The best plan for the quarter may not be best plan for five years down the road. If a key employee suddenly dies, adjustments need to be made as quickly as possible to ensure that the business continues to run. On the other hand, if that employee announces intent to retire in a few years, the best fit for the position may not be the current second-in-command. A short-term, emergency plan will ensure that the institution is not crippled by the unexpected. A long-term plan ensures that the strategic pieces are in place for when known change occurs.

B. Establish the Succession Plan's Structure

Once it has determined the strategic vision for the institution, the Board must establish the structure for the succession plan—that is, who will be responsible for drafting and implementing the succession plan? Many banks and companies establish Corporate Governance Committees specifically for this purpose because it creates an extra layer of accountability. The goal should be to involve as many key people in the planning process as necessary to ensure the plan has the proper scope. The planning team should be well-represented, but independent enough to put issues that need to be addressed on the table without fear of repercussion.

C. Identify Critical Positions

Once the goals and strategies are in place, the planning team can begin considering what positions are critical to the institution's success. This means creating plans for management and positions other than the Board of Directors and senior executive officers. To be candid, most community banks do not have a lot of "bench strength."

When you consider the potential domino effect that can result from a change of circumstances related to an essential position, the needs and requirements for other, non-executive management positions can become just as important as identifying the next chairman. Each institution has to look at its entire hierarchy and identify those positions that simply cannot be compromised. This could mean identifying positions that the institution needs but does not currently have.

D. Identify the Skills and Needs

After identifying the necessary positions, the planning team should list what characteristics, skills, etc. are desired for that position (again, in light of the overall goals and strategies). Creating a job description is an excellent way to formalize the qualifications.

For directors, one of the preliminary considerations is the appropriate size of the Board. You can control board size by implementing mandatory retirement policies, director evaluations, and termination procedures. Once the ideal number of directors is determined, address what individual qualifications and characteristics are necessary for an effective overall board. This can range from personal character traits, strategic planning experience, experience with the regulators, accounting, and other financial skillsets, etc.

For management positions, remember that the goal is to establish an effective chain of command. Missing links will only cause problems. Whether executive level or entry level, identify what the management team needs to successful run the institution. Specifically, consider characteristics such as minimum previous experience with boards of directors and management teams, leadership, communication, community involvement, team-building skills, and personality traits such as honesty and commitment. Each position has the opportunity to be tailor-made to the institution's needs.

E. Identify the People

Next, look inside and outside the institution for persons that are a good fit. The goal is a seamless transition, which will look different for each position. Looking inside the organization is often easier with respect to training and culture, but outside candidates can bring fresh, and sometimes necessary, perspective.

Regardless of whether the ideal candidate is outside of the organization or from in-house, the planning committee should address development and retention methods. An important element of a successful succession plan is determining what level of training an individual will need to successfully step into the position and its responsibilities. It is not enough to plan that the position will need some general "training." The institution should tailor the training to the individual candidate's specific needs with respect to the position.

Retention is often viewed in terms of compensation. While a critical element of staffing, effective succession planning goes beyond money. Developing the individual's skillset through additional training and education or simply providing non-monetary benefits. Again, each position should be tailored toward the end-goal of enhancing shareholder value.

F. Continuously Develop the Plan

The succession planning process should be dynamic. Developing a working plan is the goal, but plans, just like institutions, should adapt over time. The Board of Directors and the appropriate committee planning team should put in place methods of monitoring and altering the succession plan. A good idea is to make it an item on the Board's annual meeting agenda, but the Board should be flexible to address succession issues as often as is necessary.

Adopting an "if it's not broken, don't fix it" mentality is not always the best practice for ensuring the long-term health of your bank. Particularly in the current environment, predictability is a valuable asset. When change occurs, as it always does, a good succession plan will have a large impact on how well the institution responds and transitions.

VIII. ANTI-TAKEOVER PLANNING AND DEALING WITH UNSOLICITED OFFERS

A. Avoiding Unwanted Attempts to Change Control

It is not unheard of for a larger holding company or another community bank to present a community bank target with an unsolicited offer. Although our firm handled the only community bank hostile tender offer to occur in recent memory (representing the target), the offers do not generally take the route of an "unsolicited tender offer" or "hostile offer," but nevertheless, cause the target bank or bank holding company a certain degree of trepidation.

The implementation of a well thought out and strategically minded anti-takeover plan will give the community bank holding company greater mastery over its own destiny when presented with a potential unsolicited or hostile offer. The anti-takeover plan will not prevent the bank holding company from being sold if its Board of Directors believes it is in the best interest of the shareholders for such a transaction to take place. An appropriate anti-takeover plan, however, will present the Board with the luxury of time to consider an offer or to shop the institution or the ability to reject the offer or make it difficult to obtain approval for an unwanted acquiring company.

For an existing bank holding company, qualified counsel should review the holding company's charter and bylaws to determine what, if any, anti-takeover provisions already exist. Additional anti-takeover provisions should be added in connection with charter and bylaw amendments at the next regular annual shareholders meeting after full disclosure to shareholders. Banks desiring to form holding companies, because of the exemption in the federal securities laws, which eliminates the need to file a formal SEC registration in connection with the formation of the holding company if the bank charter and the holding company charter are substantially similar, are best advised to form the bank holding company, and as a second step, sometime six months to a year down the road, implement an anti-takeover plan. Once the holding company has been formed, the anti-takeover plan can be implemented with the assistance of counsel at the next regular annual meeting of the shareholders after full disclosure to the shareholders.

The primary benefits of adopting a comprehensive anti-takeover plan are fourfold:

* The existence of the plan may deter unwanted investors from initially seeking a control or ownership position in the institution.

* The plan may be a valuable negotiation tool when the Board is approached by an investor.

* The plan provides specific defenses if a tender offer or other similar maneuver is commenced.

* The existence of the plan will likely drive any potential acquiror into the boardroom instead of out to the individual shareholders directly.

Obviously, strategies for handling a takeover attempt should be considered before the situation is confronted. Numerous courts have rendered significant opinions on anti-takeover and defensive strategies. One of the main reasons for favorable decisions upholding anti-takeover defenses is the timing of the implementation of such defenses.

Corporations amending their charters and bylaws to include such protective provisions as part of advance planning have generally had the defenses upheld in court. In many cases, firms with strategies implemented in response to a specific bid have had such provisions invalidated on the basis they were put in place only to protect existing management and were not in the best interests of shareholders. Last minute, reactionary planning is usually ineffective.

Implementing a comprehensive anti-takeover plan if a financial institution does not have a holding company may be extremely difficult and ultimately ineffective. Amendments to a financial institution's charter ("articles of incorporation") as opposed to a holding company's charter, often must be approved by the institution's primary regulator. Many standard corporate provisions, such as the elimination of cumulative voting or preemptive rights and staggered election of directors for multiple year terms are expressly prohibited in archaic state and federal banking laws. Regulators are conservative even regarding what charter amendments may be used if legally permissible. In addition, if the regulatory agency ultimately allows the defenses to be placed in the charter, there is little or no legal precedent to determine whether the defenses will be upheld in court.

A bank holding company is not limited by such considerations. For corporate purposes, a holding company is a general state-chartered corporation and is limited only by the law of the state in which it is incorporated. Certain types of "structural" anti-takeover techniques may be used with a BHC as follows:

Anti-takeover Defenses	
* Stagger election of directors	* Limit shareholder written consent to approve certain actions
* Limit the size of Board	* Permit special Board meetings on "best efforts" notice basis
* Deny shareholders cumulative voting rights	* Require "supermajority" shareholder vote approval of certain takeover or acquisition transactions
* Allow director removal only "for cause"	* Provide authorized but unissued shares of institution stock
* Limit shareholder ability to replace directors	* Deny shareholder preemptive rights

* Implement director qualification requirements	* Enumerate factors directors can consider in approving or disapproving a potential takeover
* Limit director affiliations with other institutions	* Require fair price provisions in potential takeover offers
* Require non-management director nominations to meet certain requirements	* Amend shareholder voting rights under certain circumstances
* Limit shareholder called special meetings	

In addition to the previously noted structural anti-takeover techniques, there are certain general defensive strategies or "black book" procedures that should be followed, including the following:

* Prepare a limited "black book" containing a list of key personnel, including special legal counsel, financial and public relations personnel and their office and home phone numbers.

* Prepare information about how to locate all directors and key personnel on short notice.

* Identify a senior management team of three or four directors and three to four senior managers to deal with an unsolicited offer on a daily basis.

* Review shareholder list in order to ascertain shareholders' geographic location and identify key shareholders that might assist in solicitation efforts and be able to gauge shareholder loyalty.

* If the bank holding company is a publicly reporting company, the company should implement a consistent "stock watch" program to monitor the daily trading of its stock.

* Implement a shareholder and investment relations program.

* Implement safe keeping practices for your shareholder list.

* Instruct all directors and personnel to decline comment to the press with respect to offers.

* Establish a line of credit with a correspondent bank for a defensive stock repurchase program.

Employment contracts containing "Golden Parachute," "Golden Handcuff" or "Retention Bonus" provisions may also be entered into with key officers at the holding company level. Although such contracts must comply with IRS Code Section 409A, these contracts provide substantial monetary benefits to such officers if control changes involuntarily. The contracts may serve as a deterrent to "raiders" because of the cost they add to an acquisition. Most importantly, if structured properly, the contracts will help guarantee objective advice by management during a takeover attempt. Without such arrangements, management's objectivity may be influenced by negotiating with a raider who could be their future boss.

A valid anti-takeover plan and a mission statement certifying that the bank desires to remain independent do not always prevent the institution from receiving an unsolicited acquisition offer. In order to understand how to deal with an unsolicited offer, a banker must understand the difference between an unsolicited offer and an "inquiry.. An inquiry is simply an overture by another institution asking whether the institution is for sale or would sell out for something in the neighborhood of X times book value or X times earnings.

An unsolicited offer is more formal. It generally involves the receipt of a written offer by another institution for a merger or acquisition of the stock of the selling institution. An inquiry is informal and can generally be dealt with informally. An unsolicited offer, however, should be dealt with in a formal manner in order to protect the Board of Directors.

B. <u>Dealing with Unsolicited Offers</u>

Upon the receipt of an unsolicited offer from another institution, the first step that the banker should take is to consult with specialized merger and acquisition professionals and the bank's Board of Directors. Many unsolicited offers contain very short fuses. It is generally not necessary to strictly comply with the deadline set forth in the offer, but it is advisable to have counsel consult with the offeror and let them know that the Board is currently considering its options.

The Board of Directors has four basic options when faced with an unsolicited offer. Each of these options must be considered in view of the Board's extensive fiduciary duties to shareholders in this situation. Numerous issues which are beyond the scope of this brief outline are present. For further specific information, please contact us.

- Reject the offer.
- Accept the offer.
- Negotiate the offer.
- Shop around to see if there is a better offer.

Rejecting the offer out of hand is dangerous for both the individual who has actually received the offer and the Board of Directors. The offer may ultimately be rejected but the rejection should be based upon a detailed financial and legal analysis of the inadequacy of the offer in view of the criteria considered by the Board of Directors. This would include relying on charter and bylaw provisions dealing with the analysis of offers as discussed above.

A Board of Directors' acceptance of an "unsolicited first offer" constitutes a breach of fiduciary duty on its face. Many acquirors will generally make unsolicited offers based on public information regarding anticipated earnings-per-share impact on the larger holding company. If the holding company is interested in the franchise and interested in the bank, it will generally increase its offer through negotiation.

The third alternative is to negotiate the offer. Once a community bank begins to negotiate or consider the offer, the bank is clearly in play. It will be sold. Many Boards of Directors of banks desiring to remain independent have found that independence disappears once they decide to try and "negotiate" an unsolicited offer.

The fourth alternative is to see what other offers are available. In any event, when an unsolicited offer is received, the general advice is to test the waters once the bank is put into play and see what other offers are available. It is only through this mechanism that the Board can determine that it has received the highest and best price.

GERRISH SMITH TUCK
Consultants and Attorneys

Enhancing Value Through Acquisitions

I. SECRETS FOR ACQUISITIONS

In 1980, there were 14,870 independently chartered banks in the United States. There are now under 4,500. While the trend of consolidation is undeniable, any strategy – whether to buy, sell, or remain independent – can be viable in the current environment if appropriate planning occurs. The following material should assist the Board in identifying the issues and common concerns in either buying or selling a community bank or implementing a decision to remain independent and simply keep your shareholders happy by enhancing shareholder value.

A. Establish Your Bank's Strategy Early On

It is important that a community bank have an acquisition strategy that it addresses and determines annually. However, before establishing that strategy, whether it is to buy, sell, or simply remain independent and enhance value, the Board must recognize the issues associated with each alternative. In doing so, it must balance the various stakeholders' interest, including shareholders, directors, management, employees, depositors, and customers, as well as consider the market environment in which it is operating.

In addition, the Board must consider the management and capital with which it has to work. If embarking on an acquisition, how much can the institution pay and who will manage? If looking to sell, what does the institution have to offer?

1. Shareholders' Interest

It is incumbent upon the directors to consider each of the stakeholders' interests. Clearly, the shareholders' interests are of paramount importance. The shareholders' desire for liquidity and increase in market value, combined with a change in the stage of life and general aging of the shareholder population, may drive the Board's decision in one direction or the another.

In addition to the shareholders, however, the desires of top management, middle management, employees, the customer base and the community must be considered. As a practical matter, it is very difficult to have a successful sale without, at least, the acquiescence of senior management.

Even a sale which the shareholders support can be scuttled by senior management's discussions with the potential purchaser with respect to the condition of the bank and the valuation of contingent liabilities. As a result, senior management and the other parties' "needs" must be identified and met.

In addition, if ownership is fragmented, it is in the best interests of the seller and buyer to organize and consolidate the "control group" as early as possible. Any possibility of having factions develop among members of the control group should be eliminated, if feasible.

2. Market Environment

In connection with enhancing shareholder value without sale, the typical community bank is faced with a number of environmental forces, including aging of the shareholder base and lack of management succession, technology considerations, increased competition and regulatory concerns, all of which may drive the bank toward the strategy of buying additional institutions or branches to enhance value or selling their own institution to enhance value. In addition to the regulatory burden currently imposed on banks, the Consumer Financial Protection Bureau has seemed intent on increasing that burden significantly, as well as the costs associated with compliance.

3. Capital

The Board's determination of its alternatives must include how best to allocate its capital. The Board of Directors must first determine how much capital is available. This includes not only the consolidated equity of the bank and the holding company, but also the leveraging ability of the holding company. Once that number is determined, how the capital pie is "sliced" must be considered. The new reality is that community banks will be required to maintain higher capital levels than they have historically. While such capitalization levels used to qualify a community bank as overcapitalized, 9% Tier 1 and 12% total risk-based capital ratios will become the norm and practical regulatory minimums, particularly when you consider the impact of the Basel III capital rules. Even for those institutions electing to utilize the new 9% community bank leverage ratio framework, there will likely be an expectation of maintaining some level of capital cushion in order to prevent involuntary reversion to the risk-based capital framework.

In either case, does the Board use a significant portion of its capital to repurchase its own stock or does the bank use the capital to offset losses? Does it use some of that capital to buy another bank or branch? Does it use the capital for natural growth? Does it dividend that capital to its shareholders? Or, does it exchange that capital for an equity interest in another institution through sale?

Particularly in light of Basel III, the new reality with regard to minimum capital means that, across the board, community banks may suffer a lower return on equity and possibly lower pricing multiples. While final rulemaking with respect to the new "community bank leverage ratio" may reduce the capital burden on many community banks, the Board nonetheless needs to make a conscious decision, particularly in an overcapitalized community bank, as to whether to return some of that capital to its shareholders. The issue is not one of receiving "capital gains" treatment versus "ordinary income" treatment on that "extraordinary dividend" capital. The issue is getting some "value" for that excess capital through a dividend versus limited or no value through a sale, which is priced based on the company's earnings stream (though that is not to say tax considerations are irrelevant).

4. Management

Most transactions will result in existing management being retained by the acquiring institution (at least for some period of time). This is simply due to the combination of facts that (a) most acquiring institutions do not have excess management, and (b) most sellers will not be acquired if management is not assured of a position after the acquisition or otherwise financially compensated. Non-management owners should never forget that there is an inherent conflict of interest in allowing managers to negotiate with a potential purchaser when the management will be staying on after the sale. Obviously, management is then negotiating with its future boss.

5. Consideration of Potential Acquirors

If a community bank's Board of Directors has made the decision to sell the company at some point in the future - no matter how distant - so that the question is not "if" to sell the company but "when" - the Board of Directors must consider which acquirors may be available at the time it finally decides to sell. A community Board should consciously identify its potential acquirors. It should then analyze, as best it can, what may occur with those acquirors. A potential acquiror that is interested in moving into the community where the community bank operates its franchise may do one of several things:

a. It may be acquired itself and thereby be eliminated as a player.

b. If it desires entrance in the market, it may use another entry vehicle, i.e. another institution or a *de novo* branch and be eliminated as a player.

c. It may simply lose interest and allocate its resources to another strategic direction and eliminate itself as a player.

Unfortunately, if "selling" is in the community bank's current thought process, i.e. a strategy other than an adamant one for independence, sooner is probably better than later. "Sooner" will provide the maximum number of potential purchasers.

B. Planning to Acquire

Whether the Board of Directors' decision is to buy, sell or remain independent and simply enhance value, it must plan for the ultimate outcome it desires.

1. Implementing an Acquisition Strategy: Needs of the Buyer

Before finding a bank, bank holding company or thrift to buy, a buyer must first define the kind of financial institution it desires and is, from a financial and management standpoint, able to buy. The buyer must develop an acquisition strategy describing an overall plan and identifying acquisition candidates. Buyers must consider, in advance, the advantages that the buyer wishes to obtain as a result of combining with the selling institution. These benefits generally fit within the following categories:

(a) Financial

- * Earnings per share appreciation
- * Utilization of excess capital and increased return on equity
- * Increased market value and liquidity
- * Increasing regulatory burden offset by enhanced earning power and asset upgrades.

(b) Managerial or Operational

- * Obtain new management expertise
- * Additional systems and operational expertise
- * Use of excess competent management

(c) Strategic

- * Diversification
- * New market entrance
- * Growth potential
- * Economies of scale and/or scope
- * Enhanced image and reputation
- * Elimination of competition
- * Obtain additional technology expertise

2. <u>Formation of the Acquisition Team and Assignment of Responsibility</u>

(a) The Players: The Buyer and the Seller

The typical buyer in this environment will probably be a small to mid-sized holding company desiring entry into the market to expand its franchise, or a community bank slightly larger than the target, looking to gain critical mass to cover the cost of doing business.

The typical seller will be a community bank of any size in a good market with acceptable performance, and in all likelihood, with a Board that has "had all the fun it could stand". From the seller's perspective, the decision to sell an institution will generally fall into one of four scenarios:

(1) The controlling shareholders make a decision to sell after a substantial period of consideration due to the pressures of personal financial factors, estate planning needs, age, technology, competitive factors, regulatory actions, exposure to directors' liability and so forth.

(2) The institution is in trouble and needs additional capital and/or new management.

(3) The institution has no management succession and an older management and shareholder base.

(4) The Board is concerned about missing the upcoming "window."

(b) The Players: Financial Consultants, Special Counsel and the Accountants

With the status of current regulations and the growing complexity of mergers and acquisitions, few institutions are capable of closing a successful deal without outside assistance. From a technical standpoint, there is a greater need than ever before to secure the services of specialized financial consultants, legal counsel, and experienced auditors. The costs may be high, but it is a misguided chief executive who thinks he or she can economize by doing his or her own legal, accounting or even financial work in an acquisition transaction.

The primary goals of any outside advisor should be to close the deal and to protect his client's interests. To achieve these objectives, the advisor(s) must have a number of attributes and qualifications, some of which differentiate him or her from many other professionals.

First and foremost, the advisor must have the requisite knowledge and experience in business combinations and reorganizations. This not only includes a solid understanding of the intricacies of acquisition contracts and regulatory issues, but more importantly, also a high degree of familiarity with the business and financial issues that arise in community bank acquisitions.

Second and equally important, it is essential that the advisor understands the tax implications of the acquisition and provides structuring advice early on in the negotiations.

Aside from the technical skills, the advisor(s) must seek to find solutions to problems which may arise rather than simply identifying them. Instead of finding reasons for "killing a deal," which comes quite naturally to some, the talented advisor is oriented to "making the deal," unless it would result in insufficient protection for his client.

The experienced advisor knows what must happen and when it should take place. Along with the principal parties, he must maintain the momentum for the deal. Experienced professionals will prepare and work from a transaction timetable, outlining the various tasks that must be accomplished, the person(s) responsible, and target dates.

An early decision which must be made is who will actually handle the negotiations. A general rule to follow when using outside "experts" for negotiations is as follows. If representing the buyer, the experts should become involved early, but stay behind the scenes to avoid intimidating an unsophisticated seller. If the experts are representing the seller, they should become involved early in the negotiations and be visible to avoid a sophisticated buyer trying to negotiate an unrealistic or unfair deal with an inexperienced seller.

(c) Assignment of Responsibilities

Once the bank's team and advisors are in place, it is critical to specifically assign responsibilities to each member of the team. It is helpful to have one coordinator for these tasks. That coordinator is often the outside counsel or financial consultant who has experience with transactions of this type.

The assignments of responsibilities should be formalized and documented so that significant matters are not overlooked in the excitement of the acquisition process.

(d) Preparation of Candidate List

Typically, buyers find that the most difficult, frustrating and time-consuming step in buying another institution is finding an institution to buy - one that "fits." This is especially true for the first-time buyer who frequently underestimates the time and effort necessary to plan and locate viable acquisition candidates. Unfortunately, many such buyers start a search for acquisition candidates without being fully prepared. The result is early disappointment with the whole idea. Following a well-constructed plan will assist a buyer in pinpointing "buyable" sellers and reduce unproductive time.

The buyer needs to be aware that there is an inherent inclination toward acquisition. Well thought out and well planned acquisitions create value and minimize risks. Unplanned acquisitions maximize risks and limit future flexibility. Certain studies suggest that bank mergers do not guarantee major cost savings benefits. With planned acquisitions, many of the anticipated benefits will result. With unplanned or poorly planned acquisitions, they rarely do. In any event, as a buyer, be careful valuing synergies.

C. <u>Contact and Negotiation for Community Bank Acquisitions</u>

1. <u>The Approach</u>

An acquisition by a regional holding company or another community bank may be one in a series of acquisitions for that institution. It is likely, however, that the sale by the seller will be a sale by an inexperienced seller and will be that seller's first and often last sale.

a. <u>Preliminary Approach through the CEO or Principal Shareholder</u>. Many different approaches are used by potential acquirors, be they bank holding companies or other community banks, toward target community institutions. In virtually every case, however, the approach will be to the chief executive officer of the Selling Bank or its principal shareholder. Often, the CEO or other high ranking officer of the acquiror will simply call the CEO of the target and ask if he would be willing to discuss the possibility of "affiliating" or associating with it. Inevitably, the potential acquiror's representative will avoid the use of terms such as "acquisition," "sale," or "being acquired" and use the euphemisms of "affiliation," "association" and "marriage" when talking about the acquisition.

b. Getting Serious. Although potential acquirors have made various approaches in the past with respect to acquisition of community institutions in particular, virtually all potential buyers have now learned that in order to have any serious discussions with the community bank, the chief executive or chairman of the Board of the buyer needs to engage directly in discussions with the chief executive of the Selling Bank or its principal shareholder. To be effective, this needs to happen very early in the exploratory stages.

Experience has shown that the buyers that have tried to acquire banks by sending officers other than the CEO or chairman to conduct any serious discussions have generally not been as successful as those represented directly by one of them. Most community bankers understandably take the position that when they are about to make the most important decision that they will ever make for their bank, they want to directly "eyeball" the CEO of the buyer. Many understandably resent it if the bank holding company chairman or CEO does not give them at least some reasonable amount of attention.

c. The Sales Pitch. Buyers and sellers have varying interests and reasons for wanting to engage in a transaction. Usually the acquiring institution, although it is technically a "buyer," must "sell" itself to the target. This is particularly true where stock of the buyer is to be used as the currency for the transaction. The sales pitch varies with the perceived "needs" of the community bank which the buyer intends to meet as a result of the acquisition. Many times, the needs of the Selling Bank will depend primarily upon the financial condition of the seller. If the Selling Bank needs additional capital for growth or otherwise, the approach by the buyer usually emphasizes that an affiliation with the buyer will provide a source of additional capital so that the bank may continue to grow and serve its community.

If the Selling Bank is already well capitalized and satisfactorily performing, the approach usually involves an appeal to the shareholders of the community bank with respect to the liquidity of the stock of the buyer and the lack of marketability and illiquidity of the selling community bank's ownership. The buyer will also always emphasize the tax free nature of most transactions and the existing market for its stock.

In banks in which the chief executive officer is near retirement age and does not have a capable successor on board, the buyer generally emphasizes its management depth and its ability to attract successor management who will have a career opportunity with a larger organization.

In summary, the buyer will generally emphasize that it can bring to the table capital, management, liquidity for the investment, future earnings potential, appreciation, and career opportunities for employees. The specific needs of the seller will determine which of these particular benefits will be emphasized.

2. General Negotiation Considerations

In all bank acquisitions, there are some advantages that inherently go to those who are selling and others that accrue to the buyer. No matter which side you are on, two primary goals should be recognized: first, improve your bargaining position, and, second, understand the other side's position.

a. Stages of Negotiations:

(1) Preliminary negotiations leading up to determination of price and other social issues - usually represented by a letter of intent or term sheet.

(2) Negotiations leading up to execution of definitive documentation.

(3) Additional negotiations at or immediately before closing regarding last minute price adjustments and/or potential problems.

Acquisition negotiations can take a long time. It is important that both parties be patient. Although the buyer may have made several acquisitions, it is likely that the seller is taking the most important step in its history.

b. General Negotiation Suggestions for Both Parties:

(1) No premature negotiations - ignore deadlines. Make concessions late and always get something in return. The opposite is also true - take concessions and attempt to move on without giving up anything.

(2) Plan and attempt to control all aspects of negotiations including place, time and mood. The buyer usually has an advantage in this regard.

(3) Throughout negotiations, be courteous but firm and attempt to lead the negotiations. Within the general rule that the "buyer gets to draft," try to have your professionals retain control over drafting and revisions of definitive documentation.

(4) Use the "foot in the door" negotiating approach to get to higher levels of commitment. As the costs and expenses mount, a party will be more reluctant to terminate the deal since his institution will have to bear the expenses. (These expenses are usually a larger share of the seller's operating income.)

(5) Consider using letters of intent or term sheets because they:

- clear up any ambiguity or confusion over the terms of the deal,

- cause a psychological "commitment,"

- take the institution off the market and discourage other bidders, include confidentiality provisions, and

- set forth the timing of the deal.

(6) Keep communications open with shareholders. Make sure all parties in interest understand the delays associated with a bank acquisition.

(7) Always be careful of unreasonable time demands. Is the acquisition so unique that the risk of speeding up the process is justified? Are there other bidders or alternatives for the other party? Where is the pressure coming from to expedite the transaction? How will the faster pace affect the acquisition? Are there "hidden agendas" existing with advisors? Is the potential reward commensurate with the risks?

(8) Be absolutely certain that you receive competent legal advice on exactly what public disclosures should be made regarding negotiations and the timing of such disclosures. Substantial liability can occur for misleading or late disclosures.

(9) Throughout negotiations, be certain everyone understands the importance of the "due diligence" examination since so often these examinations identify major problems. Try to make certain that by the time you get to the closing documents there are no more surprises.

(10) Always attempt to use a win/win strategy. It is almost impossible to make a totally unfair and overpowering deal "stick." Regardless of the legal consequences, most people will not honor a contract if they realize they have been "taken."

c. Specific Seller Negotiation Considerations

(1) The seller should not reveal the reasons his group is interested in selling.

(2) A seller should always show a limited desire to sell. This will have the effect of forcing the buyer to "sell" itself rather than requiring the seller to "sell" his institution.

(3) Consider using a representative for negotiations so that the representative can use the strategy of saying, "I can only make recommendations to my client. I cannot commit for him."

(4) Due diligence examinations are integral parts of any acquisition. The seller should usually try to force "due diligence" examinations before any definitive document is signed or as early as possible. This avoids

premature press releases which can be embarrassing later. Also it removes the major contingency early. Termination of an acquisition, regardless of the reasons given in a press release, will nearly always damage the reputation of the seller more than the buyer. It will be automatically assumed that there is something wrong with the institution being sold.

(5) Remember the "foot in the door" negotiating approach used by many purchasers. A seller should always realize that negotiations are never over until the cash or stock is received.

(6) Bring up integration issues early in the negotiations if the post-acquisition operation of the bank is important to the seller's management and directors.

(7) Don't forget the social issues.

d. Specific Buyer Negotiation Considerations

(1) Avoid discussion of price in the initial meetings. It is too sensitive a subject to raise until some personal rapport has been developed. In determining the pricing, always consider what incentive plans must be given to management.

(2) Consider the "social issues" early on.

(3) Make no proposal until you have arrived at a clear understanding of the seller's desires and expectations.

(4) With a "cash" transaction, determine in the beginning the "financing" of the deal. Keep in mind that often a buyer, a lender and the regulators must approve the deal from a cash flow and financial point of view.

(5) If the seller is unsophisticated enough to allow its existing senior management to negotiate, the buyer should take advantage of the natural reluctance of management to negotiate "too hard" with its future boss.

(6) It is always important that there is no uncertainty about who is speaking for the buyer. Also, always make certain the person speaking for the seller controls the seller or has authority from the seller.

(7) Meetings of more than five or six people are less likely to be fruitful.

(8) Be careful of valuing synergies. They rarely exist.

(9) Identify all of the true costs of the acquisition, including the termination/deconversion fees associated with the target's data processing contract, change-in-control payments to the target's senior executives, etc. Such payments can be high, to say the least, and can have a significant impact on pricing. Identify them sooner rather than later.

Fair, honest, and straightforward negotiations will produce productive agreements. Any transaction that is "too good" for either side will generate ill will and run the risk of an aborted closing. In order for a transaction to work, it must be viewed as fair to both parties.

D. Price, Currency, Structure, and Other Important Issues

1. Pricing and Currency Issues

If pricing of an acquisition transaction is not the most important issue, then it runs a very close second to whatever is. Granted, although "social issues" play a large role in acquisition transactions and have derailed many through the years, pricing and an understanding of pricing are critical.

a. Stock or Cash as the Currency. When considering an acquisition transaction as either buyer or seller, it is imperative to make a decision up front as to whether stock or cash will be the currency. The currency will generally be dictated by the desires of the selling company. If the seller wants a tax free stock transaction, then a cash transaction will only be acceptable generally if it is "grossed up" for tax purposes, which will often make it prohibitively expensive. Particularly with the post-election "bump" many larger, regional bank's stocks experienced, stock as currency is increasing in attractiveness for many institutions. With that said, numerous questions arise which should be considered in connection with taking the stock of a holding company or other buyer. Primary concerns should be as follows:

(i) The number of shares selling shareholders will receive in relation to the perceived value of the community bank's ownership interest. Is the price acceptable based on the market value of the holding company stock being received?

(ii) The investment quality of the holding company stock at that price. Is the holding company stock a good investment at that price and is it likely to increase in value or is it already overpriced and is more likely to drop?

(iii) The liquidity in the holding company stock to be received. Is the market thin or is there a ready market available for the stock? Although a number of holding company stocks are listed on an exchange and often there are many "market makers" through regional brokerage houses in these stocks, the true market for the stock may be extremely thin.

(iv) Who bears the market risk during the length of time that will transpire between the time an agreement in principle is reached and the time the stock is actually issued to the community bank stockholder so it can be sold?

(v) The taxable nature of the transaction. Will the stock be received in a tax free transaction so there will be no taxable event unless and until the community bank shareholders sell their new holding company stock?

b. Determining Relative Value of Illiquid Shares. When two community banks are combining for stock and neither bank has a "liquid" currency, then the acquiror and the target must determine the relative value of the two banks and their contribution to the resulting entity. In other words, the banks must determine how large a stake in the new combined company the target represents, which will dictate the value of a share of target stock in terms of stock of the acquiror. This determination is generally based on a "Contribution Analysis."

To arrive at a relative value of the two institutions and their resulting share in the resulting institution, each bank's relative contribution of earnings, assets, and equity to the combined resulting holding company should be considered. Because the contribution of a large earnings stream is generally more valuable than the contribution of equity, which is, in turn, more valuable than the contribution of assets, these three criteria should be weighted accordingly. By considering the relative value of each bank's contribution to the combined entity, and by understanding which category, earnings, equity, assets, contributes more to the long-term value of the combined organization, the two combining banks can determine the relative values of the stock to each other.

c. Pricing

(i) Current Environment of Reduced Price

Once upon a time, in the middle part of this decade, banks were consistently selling for two times book value. As it was not that long ago, it is logical that a potential target bank, whose business has not materially changed, could claim that the value of his bank has not changed either. The fact of the matter, however, is that community banks are operating in a vastly different economic environment, and are selling for significantly lower multiples of book value. Even with pricing increased over the past year or so, they are still not up to pre-recession or pre-pandemic levels. Simply put, healthy banks are selling for less than what they did before the recession.

(ii) Historical Pricing

"Historical Pricing" is a method of pricing a bank deal by reference to similar deals. A bank will determine its own value by looking at prices paid for banks of similar size and profitability that serve similar markets. The fallacy of this reasoning is that a bank is "worth" only what a willing buyer will pay for it. Valuing a bank by reference to others is rarely, if ever, an effective way at arriving at an accurate value. That is why historical pricing is not considered to be an accurate indicator of a bank's potential selling price. Historical pricing can be used to see if an offer is in the correct ballpark, but that is near the extent of its value.

(iii) Price Based on Earnings Stream

As noted, although pricing in bank acquisition transactions is often reported as a multiple of book value, bank acquisition transactions are always priced based on the target's potential earnings stream and whether it will be accretive or dilutive after the acquisition to the potential acquiror. Whether or not the acquisition will be accretive or dilutive to the acquiror from an earnings per share standpoint is going to depend on the earnings stream that can be generated from the target post-acquisition. This means that cost savings obtained by the acquiror as a result of the acquisition, i.e. general personnel cuts, and revenue enhancements which will be obtained as a result of the target being part of the acquiror's organization must be considered. Generally, when considering the resulting pro forma reflecting the post-acquisition earnings stream for purposes of pricing the acquisition, the target should be given a significant credit on the purchase price calculation toward cost savings to be obtained by the acquiror. The target generally gets no credit for revenue enhancements, which are items that the acquiror brings to the table, i.e. the ability to push more product that the acquiror already has through the distribution network of the target.

Because most transactions are initially "priced" before obtaining detailed nonpublic information about the target, the potential acquiror generally needs to determine an estimate of cost savings for purposes of running its own model. The general rule of thumb with respect to savings of noninterest expense of the target is as follows:

Out of Market Acquisition	15 to 20%
Adjacent Market Acquisition	20 to 30%
In Market Acquisition	25 to 40%

Once the pro forma earnings stream for the target after the acquisition by the acquiror has been determined, it is fairly easy to determine how many shares or dollars the acquiror could give to the target shareholders without diluting the earnings of its own shareholders. Most acquirors of community banks will not engage in transactions that are earnings per share dilutive, at least that are earnings per share dilutive for very long.

d. <u>Critical Contract Considerations With Respect to Pricing a Stock-for-Stock Transaction</u>. The single most important provision in the acquisition agreement relates to how the price is determined, i.e. at what time will the number of shares to be received by the community bank shareholders actually be determined. This is important since the value of the stock, particularly if a larger, public holding company is involved, typically fluctuates day to day in the market.

Competing interests between the Selling Bank and the buyer are clearly present. The community bank's interest is to structure the price so that the dollar value of the transaction is determined in the contract, but that the number of shares to be received by the community bank increases proportionately as the market value of the holding company stock decreases up to the date of closing.

Conversely, the buyer's interest is to structure the transaction so that the value is fixed in the agreement and the number of shares or value of the transaction decreases as the price of the holding company stock increases in the market. These competing desires are usually resolved in one of several ways.

- A fixed exchange ratio that does not change no matter what the stock price is, i.e., a fixed number of shares to the seller's shareholders.

- An exchange ratio that fluctuates both up and down but has a collar and a cuff on it so that the amount of fluctuation in the exchange ratio is fixed. If there is a variation in the stock price that goes beyond the collar or cuff, the number of shares does not adjust any further.

Bank stock indices are also often being used as part of the pricing mechanism.

It is also important to obtain a "walk" provision which is utilized in the event the value of the buyer's stock drops below a specified dollar amount at a specified time or times. In that event, the seller's Board has the right to terminate the agreement without any obligation to proceed further.

As a practical matter, the "walk" provision is generally extremely effective from the seller's standpoint. In the unanticipated event that the stock of the buyer falls below the "walk" price, the community bank always has the opportunity to renegotiate the exchange ratio and thereby retain its flexibility.

The key to the "walk" provision is to determine in advance at what date the holding company stock will be valued. Many acquisition agreements provide for an average value for a twenty-day trading period which ends five days prior to the effective date of the merger. Such a provision, however, may create unnecessary problems in implementation.

It is preferable to have a "walk" provision that has a twenty day period run both from the date of approval by the shareholders of the Selling Bank and from the date of approval of the buyer's application by the Federal Reserve Board or other agency. Using these dates gives the community bank two shots at the "walk" provision. This also gives the advantage to the community bank so that if the federal regulatory approval, i.e. the "first walk date," is obtained prior to the shareholders' meeting, and the community bank determines to terminate the transaction, a proxy and prospectus need not be delivered and shareholder vote may never need to be taken.

2. Social Issues

Although pricing and pricing considerations are of paramount importance, many transactions stand or fall on social issues. As a result, oftentimes, particularly for a seller, the negotiation of social issues first makes sense. If the social issues cannot be adequately addressed, then there is generally no need to move on to price discussions. Social issues include the following:

- Who is going to run the bank or company post acquisition?
- What will the company's or bank's name be?
- Who will sit on the Board of Directors?
- What will be the compensation of the directors and/or officers remaining?
- What will be the severance provisions for officers and employees who are terminated?
- Will the institution become a branch or remain as an independent charter?
- Will employee benefits change?
- How much autonomy will the Board or advisory board and management have post acquisition?
- How much bureaucracy will be involved post acquisition?

Even an adequately priced acquisition may never close if the social issues cannot be addressed to the satisfaction of principal players. Address social issues early on.

3. Merger of Equals

It is not uncommon for community banks to consider a "merger of equals." In other words, neither bank considers itself the target. In such situations, banks should be aware that under purchase accounting rules one bank must be designated as the acquiror when accounting for the transaction. Numerous issues are presented in what are purported to be mergers of equals. Often these are referred to as "unequal mergers of equals" not only because one institution must technically be the acquiror for accounting purposes, but generally one institution deems itself to be the acquiror. As many issues as can possibly be resolved ahead of time should be. Mergers of equals are difficult to consummate and integrate.

4. Intangible Considerations Associated with the Price and Autonomy

When a Selling Bank considers selling, major concerns on the chief executive officer's mind are generally related to price of the acquisition and autonomy after the acquisition. It is generally possible to satisfactorily quantify the price provisions and build in certain protections from market value fluctuations of the holding company stock. It is not as easy, however, to get a grasp on the issue of autonomy.

The community bank executive must understand, however, that while the acquiring holding company stresses the substantial autonomy that will be given to its subsidiaries, in reality, the autonomy dissolves rather quickly as more and more authority is assumed by the acquiring holding company's main office.

It is generally true that within two or three years after the acquisition by a larger holding company, the chief executive officer of the community bank leaves and is replaced with someone chosen by the holding company. Although there are many reasons for this, the major one is that a CEO, accustomed to operating his or her own bank subject only to his Board of Directors, is simply unable or unwilling to adjust to having to respond to directions from so many people in so many areas in a larger holding company setting. For this reason, the CEO who is ready, willing and able to retire within a few years of the acquisition is in the best possible position to negotiate a good deal for his shareholders. He does not have to be so concerned about his own future at the holding company and can aggressively negotiate against the people who will be his future bosses if he stays with the bank after its acquisition.

In general, however, there is an inherent conflict between the desire for autonomy by the CEO and the best interest of the shareholders. In the usual case, the shareholders' sole concern is getting the best price in the best currency. If it is not cash, it should be in a stock that is readily marketable and is expected to at least retain its value. The CEO must be careful that there is not a trade-off on price to obtain a better deal or more autonomy for the local Board and management at the expense of the consideration received by shareholders. Usually, the shareholders are not concerned about autonomy - particularly if it is at their expense.

5. Dividends / Subchapter S Distributions

The payment of dividends or Subchapter S distributions must be considered in any acquisition transaction. Often, the community bank's dividend payment history may provide significantly less cash flow than the dividends that will be received by the community bank shareholders after application of the exchange ratio in a stock-for-stock transaction. If this is the case, then acceleration of the closing of the transaction to ensure that the community bank shareholders are shareholders of record at the time of the dividend declaration by the acquiring company should be a priority. The worst possible case is that the community bank does not pay its dividend and misses the acquiring company's dividend. This is generally avoided by providing that the community bank can continue to pay its regular dividend up until the date of closing and that the community bank will be entitled to its pro rata portion of its regular dividend shortly prior to closing if the community bank shareholders will have missed the record date of the acquiring company as a result of the timing of the closing. In other words, the community bank would get its own dividend or the acquiring company's dividend, but not both.

The acquisition of Subchapter S institutions provides an additional consideration. Subchapter S organizations make (or at least should make) "tax equivalent" distributions to their shareholders for the purpose of covering the shareholders' increased tax liability as a result of pass-through income. If a Subchapter S institution is acquired prior to making any tax equivalent distributions for the current tax year, then the target shareholders could be left with a tax liability from partial year income without any corresponding distribution.

Related, the potential for an extraordinary dividend must be considered. Since the replacement of the pooling of interest method of accounting, there are no adverse consequences to the payment of an extraordinary dividend. Indeed, in today's environment, many community banks use the extraordinary dividend to reduce their capital account to approximately 8% immediately prior to closing. The payment of an extraordinary dividend in a cash transaction will often have no adverse impact as a result of the purchase price often being tied to "core" capital, rather than including excess capital in the calculation.

6. Due Diligence Review

No matter how large the buyer or whether it is an SEC reporting company, before a seller's shareholders accept stock in an acquiring bank or holding company, a due diligence review of that bank or holding company should take place. This is similar to the due diligence review which the buyer will conduct of the seller prior to executing the definitive agreement. It is generally best to have disinterested and objective personnel conduct the due diligence review of the acquiror. Several difficulties are generally encountered in connection with this review, not the least of which often times is simply the sheer size of the buyer whose condition is being evaluated and whose stock is being issued.

An additional and recurrent difficulty involved in the due diligence review is obtaining access to the buyer's regulatory examination reports. Although these reports are intended for the use of the buyer's company and bank only, it is virtually impossible to justify recommending to the seller's Board of Directors and its shareholders that they sell to the buyer in a stock transaction if the due diligence team is denied the right to review the regulatory reports to determine if there are any material considerations that would affect the decision to sell.

It is generally most efficient for the Selling Bank to retain outside experts to either completely conduct the due diligence examination or at least assist and direct the examination with the assistance of key people from the seller. Individuals who are experienced in doing this type of work will quickly know the areas to focus on, the information necessary to obtain, and can generally facilitate a rapid due diligence review that is of minimum disruption to the buyer and maximum benefit to the seller. Most of the experienced and sophisticated buyers are used to having these reviews performed in their offices and generally they will be cooperative with respect to the process.

Even in a cash deal, prudent sellers will conduct due diligence on the acquiror to verify that the company has or has access to the cash to execute the deal, and can obtain regulatory approval. In addition, conducting due diligence on a seller can uncover problems at the front end that would later derail the deal. Spending valuable time and untold thousands of dollars pursuing a deal with no chance of success is an immense waste of time and resources. Due diligence can uncover a host of "under the radar" issues that are imminently important, even to a seller in a cash deal.

7. Fairness Opinion

Another issue that is extremely important to the Selling Bank is that the definitive agreement contain, as a condition to closing, the rendering of a fairness opinion. The fairness opinion is an opinion from a financial advisor that the transaction, as structured, is fair to the shareholders of the seller from a financial point of view. The fairness opinion will help to protect the directors from later shareholder complaints with respect to the fairness of the transaction or that the directors did not do their job. The fairness opinion should be updated and delivered to the seller bank as a condition of the seller bank's obligation to close the transaction.

Conditioning the closing on the receipt of an updated fairness opinion will also protect the seller further by permitting it to terminate the transaction in the event of material adverse changes between the time the contract is signed and the closing, which precludes the delivery of the fairness opinion.

8. Structuring

A good number of acquisitions, whether large or small, are structured as tax free exchanges of stock. It is imperative that the seller, its Board of Directors, and shareholders understand the tax ramifications of the transaction as well as the buyer's tax considerations in order to fully understand the buyer's position in the negotiations.

Any acquisition transaction will be a taxable transaction to the seller's shareholders unless it qualifies as a tax free transaction pursuant to the Internal Revenue Code. Although a detailed discussion of the structuring of the transaction and tax considerations is beyond the scope of this outline, it should be noted that often community banks are offered a tax free exchange of stock in the acquiring institution. This will be the result of either a phantom merger transaction or an exchange of shares under state "Plan of Exchange" laws. Under certain circumstance, a transaction can still be tax free for shareholders receiving stock of the buyer, even though up to 50 percent of the consideration of the transaction is cash.

It is critical that the seller use a firm that has counsel qualified to review the structure of the transaction. If a transaction is improperly structured, the result may be double taxation to selling shareholders.

It is anticipated that cash transactions will become much more frequent in the near future. From the seller's perspective, the obvious advantage to a cash deal involves a "bird in the hand." Sellers who accept cash are subject to none of the risk associated with taking an equity position in an acquiring bank and have received consideration for their shares that is totally liquid – a big advantage. On the other hand, sellers for cash are not afforded the upside potential of holding an equity interest. They will not be entitled to dividends or any subsequent appreciation in the value of the acquiror. For better or for worse, sellers in a cash deal are frequently totally divorced from the bank following the acquisition. In addition, the sale of a bank for cash will be a taxable transaction. The shareholders will be subject to income tax at capital gains rates to the extent their shares had appreciated in their hands.

There is also a unique structuring consideration when the target organization is a Subchapter S corporation. Acquisition transactions can either be structured as a sale of the target's equity (stock) or a sale of the target's assets. For tax purposes, a sale of the target's equity results in a "carry over" basis. In other words, the target company's assets have the same depreciable tax basis as they had pre-acquisition. A sale of assets, on the other hand, results in the acquired assets having a tax basis equal to each asset's fair market value. This is called a "step up" in basis, meaning that the acquirer is able to re-depreciate the assets. While this represents a significant benefit to the acquiror, a sale of assets often results in an increased tax liability for the seller.

In transactions involving the sale of an S corporation, Internal Revenue Code Section 338(h)(10) allows the acquiror to treat the acquisition of S corporation equity as a purchase of S corporation assets, thus gaining the tax benefits noted above. Because this results in increased tax liability for the sellers, however, the shareholders of the seller have to consent to the 338(h)(10) election. Selling shareholders are unlikely to bestow a benefit on the acquiror while increasing their own taxes without being compensated in some way. Thus, this structural element is ripe for negotiation.

9. Documentation and Conditions to Closing

Every buyer or seller needs to be aware of the basic documentation in acquisition transactions as well as conditions to closing. The basic documentation often used includes:

- Term Sheet
- Definitive Agreement
- Proxy Statement and Prospectus
- Tax and Accounting Opinions
- Due Diligence Report on Buyer
- Fairness Opinion
- Miscellaneous Closing Documents

It is advisable to use some kind of term sheet in a merger or acquisition. A term sheet not only provides a moral commitment, but more importantly, it evidences that there has been a meeting of the minds with respect to the basic terms of the transaction. The definitive agreement is the "big agreement." The definitive agreement generally runs from 40 to 60 pages and is full of legalese, including significant representations and warranties as well as pricing provisions, covenants that must be obeyed by the selling institution from the time of the signing of the agreement until the closing, and conditions to closing. The conditions to closing generally include financing in a cash transaction, regulatory and shareholder approval in all transactions (since they are generally structured as mergers), the receipt of a fairness opinion and the fact that there has been no material adverse change from the date of the agreement to the date of closing in the target (in a cash transaction) or in either company (in a stock-for-stock transaction).

10. <u>Dissenting Stockholders</u>

Since virtually all transactions will be structured as mergers to enable the acquiror to acquire 100% of the target's stock, the target's shareholders will generally have dissenters' rights. In a transaction structured as a merger, the vote of the target shareholders of either two-thirds (2/3) or 50%, depending on the applicable law, will require 100% of the shareholders of the target to tender their stock to the acquiror in exchange for either the cash or stock being offered unless such shareholders perfect their dissenters' rights. The perfection of dissenters' rights by a shareholder does not permit the shareholder to stop the transaction or keep his stock. It only entitles the shareholder to the fair value of his or her shares in cash. In very few transactions are dissenters' rights actually exercised for the simple fact that in a stock-for-stock transaction with a listed security, the dissenters can generally sell the stock received and obtain their cash very quickly. In a cash transaction or a stock transaction for a less liquid security, most dissenters do not have a large enough position to make it economically feasible to exercise their rights and pursue the appraisal and other remedies available. Historically, most transactions were conditioned upon no dissent in excess of 10%. This was due to some requirements for pooling of interests accounting. Even with the disappearance of pooling of interests accounting, it is likely that most transactions will retain a 10% or less dissent limitation in order to give the buyer some certainty as to the price that will be paid and the support of the shareholder base for the transaction.

It should be noted that by exercising its dissenters' rights, a shareholder is committing to accept the value of the shares as determined by a Court. This can be a gamble. If the Court determines that the stock is worth less than what is being offered by the acquiring bank, the shareholder receives less.

11. <u>Aspects of Securities Law Issues</u>

Although a thorough discussion of securities law issues is beyond the scope of this outline, virtually any acquisition, including a stock exchange by Selling Bank shareholders for a buyer's security, will need to be approved by the Selling Bank shareholders. This will require the preparation of a prospectus (for the issuance of the stock) and a proxy statement (to obtain the vote of the shareholders). There is often a temptation from the Selling Bank to allow the buyer, particularly if it is a larger holding company, to totally handle the disclosure process for the prospectus-proxy statement. The seller must remember that to the extent the document is a proxy statement for a special meeting of the seller's shareholders, it is also a securities disclosure statement of the Selling Bank and must contain all material and proper disclosures about the Selling Bank. As a result, it is imperative that counsel, accountants, and management of the Selling Bank be actively involved in the disclosure process.

Of more practical importance than the preparation of the disclosure material to the Board of Directors and shareholders of a target company in a stock-for-stock acquisition is whether their stock will be restricted from immediate sale once received. As a practical matter, in most stock-for-stock acquisitions with larger holding companies that are listed on an Exchange, a condition of the transaction is that the stock be registered by appropriate filings with the Securities and Exchange Commission. Registered stock, once received by shareholders of the target company who are not "affiliates" (insiders) of the target, can be sold immediately. Affiliates of the target, defined as directors, executive officers or shareholders holding in excess of 5% of the target's stock, are restricted from sale under the Securities and Exchange Commission Rules 144 and 145. Although these Rules are lengthy and complicated, as a practical matter, an affiliate receiving restricted shares in connection with an acquisition only can dispose of those shares under the following basic conditions:

- The sale must occur through a broker.
- The affiliate cannot sell more than 1% of the stock of the acquiring company in any three-month period (this is usually not a problem since typically, no shareholder in a community bank receives more than 1% of the acquiring company's stock as part of the transaction).
- An affiliate is subject to a holding period of six months, during which, sale of the securities is disallowed.

E. <u>Directors' and Officers' Liability Considerations</u>

Directors of a corporation (a bank and/or its holding company) are elected by shareholders and owe those shareholders the fiduciary responsibility to look out for the shareholders' best interest. Directors fulfill this fiduciary responsibility by exercising to the best of their ability their duties of loyalty and care. A director's duty of loyalty is fulfilled when that director makes a decision that is not in his or her own self-interest but rather in the best interest of all shareholders. A director's duty of care is fulfilled by making sure that decisions reached are reasonably sound and that the director is well-informed in reaching those decisions. In traditional settings, courts will rarely second-guess a Board of Directors' decision unless a complaining shareholder can clearly prove self-dealing on the part of the Board of Directors or that the Board of Directors behaved recklessly or in a willfully or grossly negligent manner. The burden is on a complaining shareholder to show that the Board did not act properly in fulfilling its fiduciary duties.

In sale transactions (sale of business, merger, combination, etc.), Boards of Directors are subject to "enhanced scrutiny" in reaching important decisions regarding the sale of the business. Boards of Directors must be able to demonstrate (1) the adequacy of their decision-making process, including documenting the information on which the Board relied on reaching its decision, and (2) the reasonableness of the decision reached by the directors in light of the circumstances surrounding the decision. In a sale of business setting, the burden shifts to the directors to prove that they reasonably fulfilled their fiduciary duties. The following is a partial list of actions that would be appropriate for a Board of Directors to take in reviewing or in making a decision whether to merge and/or be acquired or accept a tender offer in most situations:

1. The Board should inquire as to how the transaction will be structured and how the price of the transaction has been determined.

2. The Board should be informed of all terms within the merger agreement, acquisition agreement or tender offer.

3. The Board should be given written documentation regarding the combination, including the merger agreement and its terms.

4. The Board should request and receive advice regarding the value of the company which is to be bought and/or sold.

5. The Board should obtain a fairness opinion in regard to the merger.

6. The Board should obtain and review all documents prepared in connection with the proposed merger, acquisition or tender offer.

7. The Board should seek out information about national, regional and local trends on pricing a merger or acquisition.

8. Finally, the Board members should be careful not to put their own interests above the interests of the shareholders. If directors' deferred compensation or other agreements exist between the corporation, they must be negotiated, but not serve as a block to a transaction that would otherwise be in the best interests of shareholders.

The whole concept of "enhanced scrutiny" has arisen from (and, for that matter, is still being developed by) a number of Delaware Supreme Court decisions relating to hostile and/or competitive acquisition transactions. A great amount of material has been written attempting to explain the impact of these Delaware Supreme Court decisions. Not everyone agrees on exactly what these decisions mean, and lawyers and Boards of Directors continue to grapple with exactly what Boards must do to survive the "enhanced scrutiny" that courts will place on Boards of Directors in a sale of business transaction. Despite the lack of absolutely clear guidance on what Boards must do to survive the test of enhanced scrutiny, a number of general rules are becoming apparent. These include the following:

1. In a sale of business transaction, the Board of Directors must assure itself that it has obtained the highest price reasonably available for the shareholders, but this does not necessarily mean that the Board of Directors must conduct an "auction" to obtain that price.

2. The Board of Directors is obligated to "auction" the business if there is a "change in control." For example, if the selling shareholders will trade their ownership interest for shares of the acquiror and the acquiror has a dominant, control shareholder, then an auction is required to assure that the selling shareholders receive the highest price and the best type of consideration.

3. In the absence of a large control shareholder, an auction is not necessarily required if the selling shareholders receive stock of the acquiror and that stock is freely tradable on an established market.

4. If the shareholders are to receive cash in exchange for their ownership interest, an auction may be required. At a minimum, the directors must determine that they have agreed to the best available transaction for shareholders. Directors may be able to rely on publicly available pricing data for comparable transactions in reaching this conclusion.

5. In any case, directors should obtain a fairness opinion from a qualified valuation expert as to the fairness of the transaction to shareholders from a financial point of view. Directors can use this fairness opinion as a major component in satisfying their duty of care to the shareholders and surviving the "enhanced scrutiny" that the courts will impose.

Boards of Directors involved in any type of sale process or sale evaluation must take extra steps to assure that they are fulfilling their enhanced fiduciary responsibilities to the shareholders. Using board committees, specialized counsel and consultants to help the Board structure the "process" of evaluating a sale is absolutely critical to fulfilling the Board's responsibilities.

II. CONCLUSION

If your community bank is looking to remain independent, we hope you find these ideas and concepts attractive as ways not to sell your bank. Keep in mind that the decision to sell a bank is centered around the ideas that it creates the most economic value for stockholders. Simply put, if your community bank is creating enough value on its own to keep its stockholders happy, there will not be a need to sell the bank. If we can help your bank in any of these matters from a legal, financial, or strategic standpoint, please do not hesitate to contact us.

Memoranda to Clients & Friends

GERRISH SMITH TUCK, PC
Attorneys
700 Colonial Road, Suite 200
Memphis, Tennessee 38117
P.O. Box 242120
Memphis, Tennessee 38124-2120
Telephone: (901) 767-0900
Facsimile: (901) 684-2339
email: gst@gerrish.com

MEMORANDUM

TO: CLIENTS AND FRIENDS

FROM: GERRISH SMITH TUCK

DATE: JANUARY 2025

SUBJECT: RAISING CAPITAL WITHOUT REGISTERING WITH THE SEC

The purpose of this memorandum is to provide an overview of securities offerings exempt from registration with the Securities & Exchange Commission ("SEC"). Any time a bank holding company sells its common stock, that sale is a share issuance that either must be registered with the SEC and the states where the shares are sold or made pursuant to valid federal and state securities registration exemptions. It is very uncommon for a community bank holding company to sell shares pursuant to an SEC registered offering because, for many companies, access to the public markets does not outweigh the burden of complying with the SEC's reporting requirements. Accordingly, almost all community bank holding companies that choose to sell common stock do so in an exempt offering.

For those institutions, the SEC has provided a number of exempt securities offerings allowing companies to raise capital without registering the offering. The following, which is taken from information by the SEC, is a specific listing of each of the available alternatives for issuing common stock without federal registration.

Non-public offering (private placement) exemption

Section 4(a)(2) of the Securities Act exempts from registration "transactions by an issuer not involving any public offering." To qualify for this exemption, which is sometimes referred to as the "private placement" exemption, the purchasers of the securities must:

- Either have enough knowledge and experience in finance and business matters to be "sophisticated investors" (able to evaluate the risks and merits of the investment), or be able to bear the investment's economic risk;
-

- Have access to the type of information normally provided in a prospectus for a registered securities offering; and

- Agree not to resell or distribute the securities to the public.

In general, public advertising of the offering and general solicitation of investors is incompatible with the non-public offering exemption.

The precise limits of the non-public offering exemption are not defined by rule. As the number of purchasers increases and their relationship to the company and its management becomes more remote, it is more difficult to show that the offering qualifies for this exemption. If your company offers securities to even one person who does not meet the necessary conditions, the entire offering may be in violation of the Securities Act.

[redacted] provides objective standards that may be relied upon to meet the requirements of the Section 4(a)(2) non-public offering exemption. Rule 506(b) is part of Regulation D, which is described more fully below.)

Regulation D Offerings

Regulation D contains Rules 504, 506(b), and 506(c), which are the most commonly utilized means of exempting a securities offering from SEC registration. Each company offering securities exempt under Regulation D must file a Form D with the SEC, and generally must file a Form D Notice with its home state. The Form D must be filed with the SEC within 15 days after the first sale of securities under the offering. Many states also require the filing of a Form D notice in a Regulation D offering. The main purpose of the Form D filing is to notify federal (and state) authorities of the amount and nature of the offering being undertaken in reliance upon Regulation D.

Some rules under Regulation D specify particular disclosures that must be made to investors, while others do not. Even if your company sells securities in a manner that is not subject to specific disclosure requirements, you should take care that sufficient information is available to investors. All sales of securities are subject to the antifraud provisions of the securities laws. This means that you should consider whether the necessary information was available to investors, and that any information provided to investors must be free from false or misleading statements. Similarly, information should not be omitted if, as a result of the omission, the information that is provided to investors is false or misleading.

Felons and other "bad actors" are disqualified from involvement in Rule 504 and 506 offerings. An issuer seeking reliance on either of these rules is required to determine whether the issuer or any of its covered persons has had a disqualifying event. It is uncommon for community bank holding companies to have officers or directors that are felons or other “bad actors” that are disqualified from involvement.

The following addresses each of the Regulation D exemptions separately.

Rule 504

Rule 504 allows a company to sell up to $10 million of securities in any 12-month period without registering the offering with the SEC. To utilize the Rule 504 exemption, the offering company must not be an investment company or "blank-check" company and must not be currently subject to the reporting requirements under the Securities Exchange Act of 1934. Additionally, the offering company may not generally solicit or advertise the offering unless certain requirements are met. Specifically, general solicitation is only permitted in a Rule 504 if:

- It sells in accordance with a state law that requires the public filing and delivery to investors of a substantive disclosure document; or

- It sells in accordance with a state law that requires registration and disclosure document delivery and also sells in a state without those requirements, so long as your company delivers to all purchasers the disclosure documents mandated by a state in which it registered; or

- It sells exclusively according to state law exemptions that permit general solicitation and advertising, so long as sales are made only to "accredited investors" (the term "accredited investor" is described below).

Investors in a Rule 504 offering generally receive "restricted" securities, which are not freely tradable in the public markets. The investor may only resell the securities by registering the securities or by selling them under a valid SEC exemption, such as Rule 144 of the Securities Act of 1933, which requires the investor to hold the securities for a set period of time, either six months or one year, among other things. Additional information regarding the resale of restricted securities is provided below. *Please contact Gerrish Smith Tuck if you would like any additional information regarding Rule 144.*

Rule 506

Rule 506 of Regulation D is the most commonly relied upon securities registration exemption. Rule 506 provides two different ways of conducting a securities offering that is exempt from registration: Rule 506(b) and Rule 506(c). Rule 506(b) is a long-standing rule. Rule 506(c) was added in 2013 to implement a statutory mandate under the JOBS Act.

[redacted] is a "safe harbor" for the non-public offering exemption in Section 4(a)(2) of the Securities Act, which means it provides specific requirements that, if followed, establish that the transaction falls within the Section 4(a)(2) exemption. Rule 506 does not limit the amount of money a company can raise or the number of accredited investors it can sell securities to. However, in order to qualify for the safe harbor, the issuer must:

- Not use general solicitation or advertising to market the securities;

- Not sell securities to more than 35 non-accredited investors (all non-accredited investors, either alone or with a purchaser representative, must meet the legal standard of having sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment);

- Give [redacted] that generally contain the same information as provided in registered offerings (the company is not required to provide specified disclosure documents to accredited investors, but, if it does provide information to accredited investors, it must also make the information available to the non-accredited investors as well);

- Be available to answer questions from prospective purchasers who are non-accredited investors; and

- Provide certain financial statement information.

[redacted] To implement Section 201(a) of the JOBS Act, the SEC promulgated Rule 506(c) to eliminate the prohibition on using general solicitation under Rule 506. Under Rule 506(c), issuers may offer securities through means of general solicitation, provided that:

- All purchasers in the offering are accredited investors;

- The issuer takes reasonable steps to verify their accredited investor status; and

- Certain other conditions in Regulation D are satisfied.

Purchasers receive "restricted securities" in a Rule 506 offering.

[redacted] of the Securities Act provides a federal preemption or exemption from state registration and review of private offerings that are exempt under Rule 506. The states still have authority, however, to investigate and bring enforcement actions for fraud, impose state notice filing requirements, and collect state fees.

Definition of Accredited Investor

While there are a number of ways that an investor may be considered an "accredited investor" for purposes of securities offerings, the three most common types of accredited investors with respect to community bank holding company offerings are as follows:

- A director, executive officer, or partner of the offering company;

- An individual with a net worth of greater than $1 million, not including the value of the investor's primary residence; or

- An individual with greater than $200,000 in income in each of the two most recent years, or joint income with a spouse of greater than $300,000 for the two previous years, and a reasonable expectation of the same income in the current year.

If the investor does not meet any of the three most common criteria listed above, the investor may nevertheless qualify as an accredited investor if it is among the following:

- A bank, insurance company, registered investment company, business development company, or small business investment company;

- An employee benefit plan (within the meaning of the Employee Retirement Income Security Act) if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million;

- A tax exempt charitable organization, corporation, or partnership with assets in excess of $5 million;

- An enterprise in which all the equity owners are accredited investors;

- A trust with assets of at least $5 million, not formed only to acquire the securities offered, and whose purchases are directed by a person who meets the legal standard of having sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment.

Accredited Investor Exception

Pursuant to Section 4(a)(5) of the Securities Act of 1933, a company may sell up to $5 million of securities to an unlimited number of accredited investors without registering the offering with the SEC.

The definition of accredited investor is the same as that used in Regulation D, which is summarized above. Like the exemption in Rules 506(b), this exemption does not permit any form of general solicitation or advertising. There are no document delivery requirements, but all transactions are subject to the antifraud provisions of the securities laws.

Intrastate Offering Exemption

Section 3(a)(11) of the Securities Act is generally known as the "intrastate offering exemption." This exemption facilitates the financing of local business operations. To qualify for the intrastate offering exemption, the company must satisfy the following requirements:

- Be organized in the state where it is offering the securities;

- Carry out a significant amount of its business in that state; and

- Make offers and sales only to residents of that state.

The intrastate offering exemption does not limit the size of the offering or the number of purchasers. The issuer must determine the residence of each offeree and purchaser. If any of the securities are offered or sold to even one out-of-state person, the exemption may be lost, which means the company could be in violation of the Securities Act.

Moreover, if a purchaser resells any of the securities to a person who resides outside the state within a short period of time after the company's offering is complete (the usual test is nine months), the entire transaction, including the original sales made within the required state, might violate the Securities Act.

Issuers may have difficulty relying on the intrastate exemption unless the issuer knows both the persons to whom the securities are offered and the actual purchase and the sale are directly negotiated with them. If the issuer holds some of its assets outside the state or derives a substantial portion of its revenues outside the state where it proposes to offer its securities, it may also have difficulty qualifying for the exemption.

An issuer may follow Rule 147, a "safe harbor" rule under Section 3(a)(11), to ensure that it meets the requirements for the intrastate offering exemption. Rule 147 has the following requirements:

- The company must be organized in the state where it offers and sells securities;

- The company must have its "principal place of business" in-state and satisfy at least one "doing business" requirement that demonstrates the in-state nature of the company's business;

- Offers and sales of securities can only be made to in-state residents or persons who the company reasonably believes are in-state residents; and

- The company must obtain a written representation from each purchaser providing the residency of that purchaser.

Rule 147A is a more recent intrastate offering exemption adopted by the SEC that is substantially identical to Rule 147, except for the following:

- Rule 147A allows offers to be accessible to out-of-state residents, so long sales are only made to in-state residents; and

- Rule 147A permits a company to be incorporated or organized out-of-state, so long as the company has its "principal place of business" in-state and satisfies at least one "doing business" requirement that demonstrates the in-state nature of the company's business

Keep in mind, while Rule 147 and Rule 147A operate as "safe harbors" for Section 3(a)(11), it is possible that transactions not meeting all the requirements of either safe harbor may still qualify for the exemption.

Regulation A

[redacted] is an exemption providing for two tiers of exempt offerings. Tier 1 exempts from registration offerings of securities of up to $20 million in any 12-month period, so long as not more than $6 million in offers are by selling security-holders who are also affiliates of the issuing company. Tier 2 exempts offerings of securities of up to $75 million in any 12-month period, with not more than $15 million in offers permitted by selling security-holders who are affiliates of the issuing company. For each tier, sales by selling security-holders are further limited during a company's initial Regulation A offering and any subsequently qualified Regulation A offering within the first twelve-month period to no more than 30% of the aggregate offering price. Each tier is subject to basic requirements, with Tier 2 offerings subject to additional disclosures and ongoing reporting requirements. Any issuer choosing to rely on this exemption must file an offering statement with the SEC on [redacted] consisting of a notification, offering circular, and exhibits. The Form 1-A offering statement will be reviewed by SEC staff.

Felons and other "bad actors" are disqualified from Regulation A. An issuer seeking reliance on Regulation A is required to determine whether the issuer or any of its "covered persons" has had a disqualifying event.

Regulation A offerings share many characteristics with registered offerings. For example, purchasers must be provided with an offering circular similar to a prospectus. Just as in registered offerings, the securities can be offered publicly, using general solicitation and advertising, and purchasers do not receive "restricted securities."

For Tier 1 offerings, the company must comply with the state Blue Sky Laws, but the company is not subject to ongoing reporting requirements with the SEC as a result of the offering. The company would only be required to file a Form 1-Z with the SEC within 30 days after termination or completion of the offering. From a disclosures perspective, financial statements provided in Tier 1 offering materials do not have to be audited unless audited financial statements were prepared for a separate purpose.

Companies issuing securities in a Tier 2 offering of Regulation A may offer and sell up to $75 million of securities within a 12-month period. Significantly, Tier 2 offerings are not subject to state Blue Sky Laws, but the company is subject to ongoing reporting requirements with the SEC. These reporting requirements may be terminated or suspended if the issuer has no more than 300 shareholders of record in each class of stock related to the offering and no offers or sales in reliance on the offering statement are ongoing. Regulation A also requires financial statements provided with Tier 2 offering materials be audited and are required to be reviewed by an independent accountant and prepared in accordance with PCAOB standards. A company seeking qualification pursuant to Tier 2 is required to limit the amount of securities that an investor who is not an accredited investor under Rule 501(a) of Regulation D can purchase to no more than:

- 10% of the greater of annual income or net worth (for natural persons); or

- 10% of the greater of annual revenue, or net assets at fiscal year-end (for non-natural persons).

The "test the waters" provisions of Regulation A allow companies to publish or deliver a written document to prospective purchasers or make scripted radio or television broadcasts to determine whether there is an interest in their contemplated securities offering before filing an offering statement with the SEC. This gives companies the opportunity of being able to determine whether enough market interest in their securities exists before they incur the full range of legal, accounting, and other costs associated with filing an offering statement with the SEC. Companies may not, however, solicit or accept money for securities offered under Regulation A until the SEC staff completes its review of the filed offering statement and the company delivers offering materials to investors.

A company that has not previously sold securities pursuant to a qualified offering under Regulation A or an effective registration statement under the Securities Act may submit a draft offering statement for non-public review by the staff. The draft will need to be substantially complete when you submit it to the SEC via EDGAR. This nonpublic submission and any amendments to it must be filed publicly at least 21 calendar days before the qualification of the offering statement.

SEC reporting companies are not eligible to use Regulation A. All other types of companies may use Regulation A, except development stage companies without a specified business (for example, '[redacted]') and investment companies registered or required to be registered under the Investment Company Act of 1940. In most cases, shareholders may use Regulation A to resell up to $6 million of securities for Tier 1 offerings and $15 million of securities for Tier 2 offerings.

<u>Exemption for sales of securities through employee benefit plans — Rule 701</u>

SEC [redacted] exempts certain sales of securities made to compensate employees. This exemption is available only to companies that are not subject to Exchange Act reporting requirements. The issuer can sell at least $1 million of securities under this exemption, regardless of the issuer's size, and may be able to sell even more if it satisfies certain formulas based on the company's assets or on the number of its outstanding securities. If an issuer sells more than $10 million in securities in a 12-month period, the issuer is required to provide disclosures to its employees that include certain financial and other information.

Employees receive '[redacted]' in these transactions and may not freely offer or sell them to the public, unless the securities are registered or the holders can rely on an exemption.

<u>Crowdfunding Exemption</u>

The JOBS Act established a separate exemption called "crowdfunding" that allows companies to sell up to $5,000,000 in securities in any 12-month period without registering the offering with the SEC. This exemption is intended to allow companies to utilize a third-party intermediary, known as a "funding portal," to raise a small amount of money from a large number of individuals. Specifically, individual investors cannot, in any 12-month period, invest greater than:

- $2,500 or 5% of the investor's annual income or net worth, (excluding value of primary residence) if such annual income or net worth is less than $124,000; or

- 10% of the investor's annual income or net worth (excluding value of primary residence), but no more than $124,000, if such annual income or net worth is greater than $124,000.

The SEC has released a Small Entity Compliance Guide, which may be found here: https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm.

Resale of Restricted Securities

One item of particular note to consider when selling common stock pursuant to a valid registration exemption is the fact that the shares issued are "restricted securities," which are securities that are held by security holders that are not freely tradable because the shares were acquired in an offering that was exempt from registration. After acquiring restricted securities, the security holders can only resell the securities into the market by using an "effective" restriction statement (the only time this alternative ever practically occurs is in connection with an acquisition transaction where the acquiror, i.e. the issuer of the restricted securities, agrees to register those securities within a certain amount of time after closing) or pursuant to a valid exemption from the registration requirements of the securities, namely Rule 144.

Securities Act [redacted] provides an exemption that permits the resale of restricted securities if a number of conditions are met, including holding the securities for six months or one year, depending on whether the issuer has been filing reports under the Exchange Act. Rule 144 may limit the amount of securities that can be sold at one time and may restrict the manner of sale, depending on whether the security holder is an "affiliate" of the company – that is, a person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the company.

If holders of restricted securities want to resell using an effective registration statement, the issuing company can provide a registration statement for them to make sales in a public offering by following the process for registering a public offering of securities.

The SEC has put together a very helpful reference table for requirements under each of the exempt offerings noted in this memorandum, a copy of which is attached. Please note that neither this memorandum nor the attached table is intended to be a complete discussion of exempt offering requirements. Before your bank or holding company conducts any type of securities offering, exempt or otherwise, make sure to contact competent professionals.

If we can assist your organization with a securities offering or any other matter, or if you would like additional information on the exemptions discussed in this memorandum, please let us know.

JGM/SAS

GERRISH SMITH TUCK, PC
Attorneys

MEMORANDUM

TO: CLIENTS AND FRIENDS

FROM: GERRISH SMITH TUCK, PC

SUBJECT: EXECUTIVE EQUITY OWNERSHIP

DATE: JANUARY 2025

A number of our community bank clients are considering methods to attract, retain and incent the senior executive officer group by providing equity ownership in the company. There are several different plans and agreements banks and holding companies use to provide an incentive to executives and officers by providing equity ownership in a way that will encourage long-term employment. Equity ownership for executives and officers is an excellent source of motivation to grow the value of the stock.

Although there are a number of hybrid plans, the basic types of equity-based incentive plans discussed in this memo are:

- Employee Stock Ownership Plans ("ESOPs") or 401(k) Employee Stock Ownership Plans ("KSOPs"),
- Employee Stock Purchase Plans,
- Incentive Stock Option Plans,
- Nonqualified Stock Option Plans,
- Restricted Stock Plans,
- Stock Appreciation Rights or Phantom Stock Plans, and
- Stock Bonus Plans.

1. ESOPs or KSOPs. ESOPs and KSOPs are qualified retirement plans with operational rules similar to 401(k) Plans or Profit Sharing Plans. However, ESOPs and KSOPs are designed to invest primarily in employer stock. ESOPs and KSOPs must comply with discrimination rules for qualified plans under the Internal Revenue Code so the plans cover a broad cross section of employees and not just executives. A KSOP is basically an ESOP, but with a 401(k) feature that allows employees to defer a portion of their compensation into the plan. The use of an ESOP or KSOP in a Subchapter S is significantly beneficial to the employees due to the KSOP's ability to accumulate cash with which to buy shares coming on the market or issued by the holding company.

The ESOP or the KSOP can include a vesting schedule so that the participant in the plan becomes vested in his or her account balance under the plan over a six-year period (or less).

There are a number of tax advantages associated with an ESOP or KSOP. One of the primary other advantages of the ESOP or KSOP is the incentive to the plan participant to make his or her plan account grow by increasing the value of the stock. The plan gives each participant a stake in the bank holding company and bank without having to make payments personally for the stock that is purchased with employer contributions to the plan. The ESOP or KSOP can purchase newly-issued shares or existing shares held by stockholders. ESOPs and KSOPs are often used as a vehicle to purchase stock from elderly shareholders or from the estates of deceased shareholders.

We have formed ESOPs and KSOPs for dozens of community bank clients over the years. If you would like more detailed information, please let us know.

2. Employee Stock Purchase Plans. If a Stock Purchase Plan was designed whereby executives (or other employees) could purchase stock at a discounted price that is less than fair market value, the Bank would be required to give the purchaser of the stock a 1099 at the end of the year for the difference in the fair market value and the purchase price and the employee would be required to pick up that amount as taxable income. However, Section 423 of the Internal Revenue Code authorizes an Employee Stock Purchase Plan whereby an employee can purchase company stock at a discount of up to 15% without incurring taxable income on the discount amount.

There are basically nine requirements for this type of plan:

a. The plan must be in writing and purchase rights may be granted only to employees of the employer corporation or its parent or subsidiary corporations to purchase stock in any such corporation;

b. The plan must be approved by the stockholders of the granting corporation within 12 months before or after adoption of the plan;

c. 5% owners must be excluded from participation in the plan;

d. All employees of the designated participating corporations must be eligible to participate, with the possible exception of four categories of employees (persons employed less than two years, part-time employees, seasonal employees, and highly-compensated employees);

e. The same rights and privileges must be available to all participants (with the possible exception of certain designated limits on participation);

f. The purchase price of stock must be no less than the lesser of 85% of the stock's fair market value on the grant date of such purchase right or 85% of the stock's fair market value on the exercise date of such purchase right;

g. The offering period may not extend beyond five years (if the purchase price is not less than 85% of the stock's fair market value on the exercise date) or 27 months (if the purchase price is determined in any other manner);

h. A $25,000 annual accrual limit must apply to grants under the plan; and

i. Purchase rights must be nontransferable other than by will or the laws of descent and distribution and exercisable only by the participant during the participant's lifetime.

3. <u>Stock Option Plans.</u>

a. Typically, bank holding companies are adopting Incentive Stock Option Plans ("ISOPs") for the bank executives and Non-Qualified Stock Option Plans ("NQSOPs") for the directors of the bank and/or the holding company. An ISOP is a plan that is authorized under the Internal Revenue Code ("Code"). ISOPs are tax advantaged in that, if all the Code requirements are met, the optionee will not be taxed when the option is granted nor will the optionee be taxed when the option is exercised (except that when the option is exercised, the difference in the fair market value of the stock at that time less the exercise price, will be a tax preference item for purposes of the alternative minimum tax). An ISOP can only be used to grant options to employees such as executives. Options under an ISOP cannot be granted to directors who are not employees.

b. For this reason, NQSOPs are often adopted at the same time as ISOPs. NQSOPs are used to issue options to directors. There are no Code requirements for NQSOPs and NQSOPs are not tax advantaged. As long as options under NQSOPs are not transferable and have no market value, there is no tax imposed when an option is granted under an NQSOP. However, when an option under an NQSOP is exercised, the optionee recognizes ordinary income for tax purposes on the difference between the fair market value of the stock at that time and the exercise price. At that time, the employer receives a tax deduction for the amounts recognized as income by the optionee.

c. Features of a typical ISOP are:

(1) When stock is sold that was acquired by exercise of an ISOP option, the taxable gain that will be taxed is the lesser of (i) the fair market value of the stock less the basis (cost) in the stock or (ii) the amount realized on the sale less the basis (cost) of the stock. The gain will be taxed at capital gain rates assuming the stock is sold at least two (2) years after the option

is granted and one (1) year after the option is exercised. If the stock is sold within two (2) years after the option is granted or one (1) year after the option is exercised the gain is taxed as ordinary income.

(2) The employee must be employed at all times between the grant of options and the period ending not later than three (3) months before the exercise of the option (12 months if the employee is disabled).

(3) There are basically seven (7) requirements for an ISOP:

(a) The plan must be in writing and approved by the shareholders.

(b) The option must be granted within 10 years after the plan is adopted.

(c) The option must be exercised only within 10 years after the grant of the option.

(d) The option price must not be less than fair market value at the time it is granted.

(e) The option must be non-transferable, except by death and can be exercised only by the employee.

(f) The employee, at the time the option is granted, must not own, directly or indirectly, more than 10% of the employer's stock (This is waived if the option price is 110% of fair market value and requires exercise in 5 years after the option is granted for options granted to owners of more than 10% of the stock.).

(g) The aggregate fair market value (determined at the time of the grant) of the stock exercisable for the first time by an employee during any calendar year cannot exceed $100,000. There is no ceiling on unused limits carried forward.

(4) If an executive holds more than one Incentive Stock Option ("ISO"), the ISO's do not have to be exercised by the holder in the order they are granted.

(5) A special IRS ruling provides for a cashless exercise of an ISO so that ISO's can be exercised with other stock of the corporation without a tax to the employee.

(6) If an ISOP allows for the granting of options over a period of years but a special provision allows for the grant and/or exercise of the options all at

once in case of a change-in-control, this would be a golden parachute feature and the golden parachute tax consequences will likely apply.

(7) An ISO can be issued with a vesting schedule included.

d. Typically, a NQSOP will contain the same provisions as the ISOP, but this is not mandatory. The NQSOP does not have to grant the option with an exercise of fair market value but typically this is required. Options under a NQSOP may be granted to executives as well as directors, but, as stated above, the ISOP is usually adopted for executives and the NQSOP is usually adopted for directors.

4. Restricted Stock. Restricted Stock Plans generally grant stock to executives with certain restrictions. The restrictions may be that certain financial goals must be met before the restrictions lapse or that the executive must continue to be employed for a certain number of years or both. If the conditions associated with the restrictions are not met, the stock is forfeited. The restricted stock may have favorable tax benefits in that the executive is not required to recognize ordinary income for tax purposes when the restricted stock is issued. An example of how a Restricted Stock Plan works is as follows:

> 1,000 shares of non-transferable stock might be issued to the executive of the bank, subject to the restriction that, if he leaves the employment of the bank within five years, he will forfeit all the stock. Assuming that this condition constitutes a substantial risk of forfeiture, the executive will not be required to recognize income under IRC §83 until the restriction of forfeitability lapses in five years. Another condition could be that the restriction does not lapse until certain levels of earnings or other financial goals are reached.
>
> The executive will be taxed on the value of the stock when the restrictions lapse and the conditions are met, however. Thus, if the value of the stock has gone from $30 a share to $50, he will have $50,000 of ordinary income in the fifth year. Because he might not want to sell his stock at that time, this could impose an extreme cash flow hardship.
>
> If, instead, the executive makes an "83(b) election" as authorized under the Internal Revenue Code, he would have had to include $30,000 in his income in the year of receipt of the restricted stock, but would have been able to defer recognition of the $20,000, (due to the increase in the stock's value), until the stock was sold, which might be 10 or 15 years later. The $20,000 would be taxed at capital gains rates. The numbers in this example are such that the immediate inclusion of $30,000 in taxable income would normally be very unattractive. However, if the current price of the stock was low, say $15 per share in the above example, and substantial appreciation was anticipated, a Section 83(b) election would probably be advisable, since it would be made at a low present tax cost

with a possibility of significant tax deferral. Also, the granting of the restricted stock could be spread over a period of years to lessen the tax effect of the 83(b) elections. Granting of the restricted stock can be linked to bonuses that help to pay the tax obligation imposed if the 83(b) election is made.

A modification of the above example would be for the company to sell the restricted stock to the executive for $30 a share (fair market value), so that a §83(b) election could be made at no current tax cost. The bank could loan to the employee part or all of the $30,000 required to purchase the stock, subject to the limitations under Part 215 of the FDIC Regulations entitled "Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks" (Regulation O). The loan could be made repayable immediately, if the executive left the bank's employment. A part of the executive's bonus each year can be designated to retire the loan.

5. Stock Appreciation Rights Plan (“SAR Plan”) or Phantom Stock Plan (“PS Plan”).

An SAR Plan or PS Plan does not actually award any stock or equity interest or represent an ownership interest in the employer by the executive. Instead, the executive has an account balance established under either type of plan. The executive is entitled at some point in the future to receive cash payments based on the account balance. Benefits may also be linked to financial performance of the bank or the continued employment of the executive or both. Typically, benefits are paid in case of death, disability, retirement, after a period of years or when a change in control occurs. Benefits may be paid in installments or a lump sum.

Benefits accrue under an SAR Plan based on the appreciation in a share of stock from the time the SAR unit is granted until a future time, such as when the benefit is paid. Benefits accrue under a PS Plan based on the entire value of a share of stock from the time a PS unit is granted until a future time.

The payments under an SAR Plan or PS Plan are accrued by the bank and paid on a contractual basis to the executive. No year to year funding is required. The executive is not required to recognize taxable income under an SAR or PS Plan until a payment is received.

6. Stock Bonus Plans. Stock Bonus Plans simply grant shares of stock to an executive. The executive has ordinary income based on the stock value for tax purposes and the bank has a tax deduction in that amount. The bank is required to withhold taxes based on the value of the stock when granted. A Stock Bonus Plan may be structured so that certain goals have to be met before the stock is issued.

Because of the unfavorable tax consequences to the executive, Stock Bonus Plans are not as widely used as stock options and the other types of plans discussed above.

7. Accounting Expense. Many of the above plans require a compensation expense to be accrued by the bank when the benefit is granted for accounting purposes. The compensation expense will, of course, reduce earnings. There are a number of lengthy detailed accounting standards that currently are applicable to the various types of plans. If you would like more information on the accounting requirements for any of the above alternatives, please let us know.

Please contact us if you would like to discuss any of these alternatives in more specific detail or you would like more specific written information.

GET/dm

GERRISH SMITH TUCK, PC

700 Colonial Road, Suite 200
Memphis, Tennessee 38117
P. O. Box 242120
Memphis, Tennessee 38124-2120
Telephone: (901) 767-0900
Facsimile: (901) 684-2339
gst@gerrish.com

MEMORANDUM

TO: CLIENTS AND FRIENDS

FROM: GERRISH SMITH TUCK, CONSULTANTS AND ATTORNEYS

SUBJECT: CORPORATE TRANSPARENCY ACT

DATE: JANUARY 2025

The Corporate Transparency Act (the “Act”) became effective January 1, 2024 and requires all business entities meeting the definition of a Reporting Company to file a Beneficial Ownership Information Report prior to January 1, 2025. For purposes of the Act, a Reporting Company is basically any corporate entity, with certain exceptions, as further described below. Following a Reporting Company’s initial provision of the required report, there are no further annual or quarterly filings required. However, Reporting Companies must file an amendment within 30 days after any change to their reported information.

The Act directs the Financial Crimes Enforcement Network (a unit of the Department of Treasury, known as “FinCEN”) to create a massive database of business “beneficial” ownership information for use by the government in identifying the individual owners of privately held assets.

Companies that are required to report under the Act include any corporation, limited liability company, limited partnership, limited liability partnership, business trust, or other entity created by the filing of a document with any Secretary of State (or similar office) or an Indian Tribe.

There are 23 narrowly-drawn exceptions to the beneficial ownership reporting requirements under the Act, which essentially relates to entities that are already subject to substantial regulation and reporting requirements, such as publicly traded companies, banks and bank holding companies, credit unions, broker-dealers, insurance companies, non-profit corporations, political organizations and certain tax-exempt trusts. There are additional types of organizations that are exempt from the reporting requirements of the Act.

In addition, there are two other categories of entities that are exempt from reporting under the Act. First, there is an exemption for "large operating companies," which are companies that meet each of the following requirements:

- More than 20 full-time employees in the US;
- Reported more than $5 million in sales or gross receipts on previous year's tax return (which includes receipts and sales from subsidiaries owned by the entity); and
- Have a physical office with an operating presence in the US.

Second, the reporting requirements do not apply to inactive business entities, which are those entities that meet the following requirements:

- have been in existence for over one year and are not engaged in an active business;
- are not owned by a foreign entity or person;
- have not had a change in ownership in the last 12 months or received funds in an amount greater than $1,000; and
- do not own any assets including an interest in any other entity.

While the exact form and mechanics of filing have yet to be set out by FinCEN, the reports are expected to be filed electronically through an online interface. The information that will be reported on the Report concerns beneficial ownership about the Reporting Company, including names, address, date of birth, driver's license number and photocopy of a government issued ID. So, the question is who is a beneficial owner? Beneficial owners include any individual who, directly or indirectly, (i) exercises substantial control over the entity (e.g., any senior officer) or (ii) owns or controls 25% or more of the ownership interests. Once a Reporting Company files its initial report, there are not annual or bi-annual updates required; instead, the only on-going reporting requirement is to make updates and amendments to the initial report in the event of a change in the beneficial ownership of a Reporting Company.

The primary goal of the Act is to provide law enforcement with beneficial ownership information for the purpose of detecting, preventing and punishing terrorism, money laundering and other misconduct through business entities. Although banks and their parent holding companies are exempt from the Act and its reporting obligations, the vast majority of bank customers that are corporate entities will be required to comply with the provisions of the Act. Recently, on December 21, 2023, the bank regulators released an Interagency Statement for Banks Regarding the Beneficial Ownership Information Access Rule, a copy of which is attached hereto for your review. As provided in the Interagency Statement, the Act and its rules will not create a new regulatory requirement, or a supervisory expectation, for banks to access Beneficial Ownership reports.

Therefore, there are not changes to the BSA/AML compliance programs anticipated at this time. However, the Act does direct FinCEN to revise the 2016 Customer Due Diligence Rule to bring it into conformity. Therefore, we anticipate that the "know your customer" due diligence rules adopted by bank regulators will be impacted by the Act at a later date.

It is important to understand the Act and its provisions. While banks and bank holding companies are not specifically subject to the provisions of the Act, we expect the majority of bank customers that are corporate entities will be subject to compliance with the Act. This is important due to the harsh penalties associated with non-compliance. Failure to timely file the report could result in fines of $500 per day, up to $10,000 maximum, or two years' jail time.

Please feel free to contact Philip Smith or Greyson Tuck if you have questions or would like to further discuss any provision of the Act or its impact on any corporate entity.

Attachment

The Board Chair Forum

The

Board Chair Forum

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys
January 2025

Welcome to the new year! The *Board Chair Forum Newsletter* is off to a great start in 2025 based on the tremendous turnout and great discussion by Board Chairs, Directors, and other leaders at the annual Community Banking Board Chair Forum that we hold every year. On January 9th and 10th we had 46 attendees from 21 different states in Marco Island, Florida for a wide-ranging open forum discussion of key issues impacting community banks. We believe it was our best Forum yet, and we want to send special thanks and appreciation to the Barret School of Banking and its Executive Director, Chris Kelley, for hosting and sponsoring the event.

In this month's *Board Chair Forum Newsletter,* you will see some of the key topics and takeaways from the event and we hope many more of you will try to attend next year. We also hope you will gain some insights from some of the additional discussions we are highlighting in this month's newsletter, and we look forward to your questions and comments.

Happy Reading!

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 [redacted]

The

Board Chair Forum

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys

January 2025

Board Chair's Summary

- ***Focus on the Fundamentals***
- ***Trump Won - Now What?***
- ***Board Lessons from Silicon Valley Bank***
- ***Strategically Plan to do Strategic Planning***

Focus on the Fundamentals

At the 2025 Board Chair Forum we held in Marco Island, Florida, it was interesting for us to hear how, with all of the new issues and concerns being faced by the community bank Board Chairs and Boards of Directors in general, there is a constant need in the midst of all of that chaos to continue focusing on the fundamentals. Yes, there is an appropriate time and place for the Board to be rightfully engaged in discussions about mergers and acquisitions, how best to position the organization from a technology standpoint, how the community bank can use artificial intelligence in a meaningful way, what changes in regulations might occur under a new administration, and other key factors. However, for many Board Chairs, it is also about going back to the fundamentals to ensure that the Board of Directors is fulfilling its core obligations in the most basic way.

Key examples where the Board Chair should lead include simple things like the length of board meetings and the topics covered. When is the last time you updated your agenda? Do you spend your meeting time merely discussing loans and financial information from the past quarter, or do you allocate specific time for strategic discussions and positioning the organization for the next year? Has your committee structure changed in recent years? If not, it needs to be updated, we would suspect. What committee do you have that is responsible for new technology initiatives? What committee do you have that has the responsibility for working with management and overseeing investment activities?

Similarly, what does the composition of your Board look like? Do you have mandatory retirement but not really use it? If you do not have mandatory retirement, do you have a written list of director expectations against which board members can be evaluated? Should board members be required to have a minimum number of education hours a year (this is certainly a growing trend among community bank boards)? If the Board Chair is an insider of the organization, which director is appointed as the Lead independent outside Director in charge of executive sessions for the Board? Do you periodically hold executive sessions as a matter of good corporate governance?

The list of these types of fundamental questions could go on for pages, but we hope you see the point here. At the beginning of the year, it is often a good time to revisit the most fundamental aspects of what community bank boards do, because later throughout the year as we get into our routines, whatever we have started at the beginning of the year becomes the routine, and often it may not be the best way to structure your Board, meet governance requirements, etc. We believe it is the Board Chair's job to fundamentally assess what the Board is doing on the most basic elements of Board operation and to make changes where appropriate. If we can ever be of assistance in helping you evaluate all of that and determine if changes are needed or make recommendations, we would be happy to do so.

Trump Won - Now What?

Well, since the *Board Chair Forum Newsletter* was last published, we have had a Presidential swearing in ceremony and a transfer of power without any major problems (thank goodness!). So, now that the new administration has been fully inaugurated and appears to be moving at record pace, at least in terms of Executive Orders and other preliminary items, in what ways will the change in administration impact your bank? Will there be any impact at all? And if so, will that impact be positive or negative?

We find that many of our clients across the country, regardless of their personal politics or their like or dislike for the newly elected President and Vice President, generally believe the Trump Administration will produce results that are favorable to the overall business climate as well as to financial institutions in general. The most likely area we will see some substantive change may initially be in the area of regulatory relief. So, a word of caution in this area. While we believe deregulation is appropriate and necessary for the banking industry and for community banks in particular, and while it is without argument that regulatory costs and burdens fall disproportionately on community banks and smaller banks in general, history has shown us that during times of deregulation there also tends to be increased profitability for banks as organizations are willing to take on more risk. That initially seems like a positive, but that increased profitability may often be the result of a more lax approach to regulatory compliance and loan underwriting, which often leads to asset quality concerns in the middle of the next economic cycle. As a result, our caution is to take advantage of all the benefits of deregulation, but do not allow a mindset to creep into the Board that the organization can now let down its guard on credit quality, loan underwriting, or even compliance. Those regulations are likely to still play a prominent role in the health of your bank and regulators will always be regulators with a core focus on Capital, Asset quality, Management, Earnings performance, organizational Liquidity, and Sensitivity to interest rate changes. So, stay on your guard!

In looking at some of the recent pronouncements, there may be a number of possible areas where community banks will benefit under the new Trump administration. Some of the key areas we have seen mentioned are set forth below. However, we would caution that these are only possibilities and not guarantees. Some of the more important items we have seen are as follows:

- Credit Union legislation

- Tiered regulation
- Reduction of emphasis of CFPB
- New agency heads at the FDIC, OCC and CFPB
- Freeze on new rulemakings
- Reversal of Biden-era rules and policies, including ESG matters
- Shift in exam focus to risk-based supervision
- Appointment of National Crypto Council
- Reduced obstacles to *de novo* bank formation
- Curtailment or revision of the 2023 Merger Guidelines to encourage M&A
- Potential easing of regulations regarding digital assets and fintech.

Board Lessons from Silicon Valley Bank

We are sure most everyone will remember Silicon Valley Bank, which in 2023 was the first major bank failure that occurred in a number of years. At the end of 2024, the FDIC indicated the possibility of suing six former officers and 11 former directors of Silicon Valley Bank, so, whenever you hear of bank directors being sued, it is worth taking note and trying to learn some lessons from the nature of the allegations being made against them. From a recent article published on the matter, some of the key takeaways are discussed below.

Along with criticizing the officers, it appears a key focus was on the argument that the directors should be held accountable for breaches of their fiduciary duties in mismanaging the bank's investment portfolio. Additionally, it was noted that directors who served in the same position as directors of the bank holding company allowed the payment of a dividend from the bank to the holding company, even though the bank was experiencing financial distress. It was argued, therefore, that as a result of those actions by the directors, the bank suffered billions of dollars in loss and ultimately leading to the bank's closure by the regulators.

In reading that allegation, what is the takeaway for your Board? We would suspect that a typical answer might be to question why the Board is being sued for management practices. Aren't bank management or the investment officers the primary parties responsible for making investment decisions, not the Board of Directors? Isn't it the bank management that makes a recommendation to transfer funds from the bank to the holding company for whatever reason, and the Board is merely a general oversight function and should not be micromanaging day-to-day bank activities? We would suspect those would be perfectly valid defenses that might be argued by the directors, but the point here is that at some level the regulatory agencies believe that the Board bears some responsibility. For most of our clients, we see this evidenced even in your typical examination reports, with somewhat of the catchall terms like "enterprise risk management" or "board duties." These oversight functions seem hard to pin down and it is true they tend to be brought to the forefront anytime there is a problem because the regulators can always point to statements like "failure to exercise proper oversight" or "inappropriate enterprise risk management functions" to say that the Board was not doing enough.

It may be that the directors of Silicon Valley Bank wind up bearing no liability (and we believe there is a good argument that they probably should not be held liable or maybe, at a minimum, the directors' and officers' insurance policy should cover their actions), but it points out the fine line directors continue to have to walk between not micromanaging the bank yet maintaining their fiduciary duties of "oversight" and appropriate "enterprise risk management." It remains a truism of director service that you should not micromanage, but it also points out the obligation of directors to question activities of management, exercise oversight functions and act on concerns they see, ask appropriate and often probing questions of management, and if it doesn't look right, it doesn't feel right, or it is not the way you would manage your own organization, it is probably best to take a different course of action.

Strategically Plan to do Strategic Planning

Do you have a strategic plan to do strategic planning? By that we mean have you thought about it, do you have a date, time and location in mind, have you thought about the types of issues or emerging trends you would want to cover, will you use an outside facilitator, etc. As most of you know, we facilitate scores of planning sessions every year (82 total in 2024), but far too often we see banks almost forget about strategic planning and rush into it at the last minute, trying to throw something together, and occasionally calling us at the last minute to see if we have time to come to their bank and talk about a few things. Might we suggest a better approach.

The Board Committee should take some time to really think strategically about what you want your strategic planning efforts to look like and what you want them to accomplish. No, you do not need an outside facilitator every year (although we are happy to fulfill that role and often do), but you should give some thought to what needs to actually be addressed at your meeting. In particular, you need to consider if you want your planning session to be a bit more focused on "intangible" items like discussing the Mission Statement, revisiting Strengths, Weaknesses, Opportunities, and Threats, making sure you outline a new Vision Statement, really focusing on employee engagement and a new customer experience, etc. We believe all those are appropriate and valid discussion points for some organizations.

Alternatively, you may find that your current need is to focus a bit more on "tangible" items. How do we get out from under our MOU, where do we want our capital to be positioned, do we want to pursue growth in the coming year or do we really want to focus on improving asset quality, what are the shareholders' expectations of return on equity, do we need to change our organizational structure, etc.

One of the things we tell our clients and future clients is that no two strategic planning sessions are alike, and that includes strategic planning sessions in separate years for the same organization. There should be no template that you follow to check the boxes just to try to make the regulators happy. If you are going to take the time and spend the time to do planning, give it some strategic thought ahead of time, get some buy-in of what really needs to be accomplished and then set about doing that. By making a plan for your plan, you will find that your time is better spent, it is more efficient, and produces better results. Of course, we would be remiss to not say that if you are looking to hire an outside facilitator, you should always get that on your calendar early, particularly for those firms or institutions where available slots tend to fill up quickly!

Meeting Adjourned

Looking ahead to 2026 (since of course you need to be thinking strategically well in advance) the next Community Banking Board Chair Forum is scheduled to take place at the JW Marriott at Marco Island on January 26-27, 2026. We will be sending sign-up information in future newsletters, but you will want to book your spots early since we were at capacity this past year. If we continue to have tremendous support for the Forum, we will even consider hosting a separate Forum in a different part of the country if there is enough demand. So, if you would like to see a Forum held in the middle of 2025, we would welcome your feedback along with some indication of where you think a good location might be. We would love to hear from you. Let's all have a great year!

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: [redacted]

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 [redacted]

Gerrish's Musings

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 ♦ [redacted] ♦ [redacted] ♦
Website: www.gerrish.com

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Dear Subscriber:

Greetings from Nebraska, South Dakota, Minnesota, North Dakota, Virginia, and Tennessee!

EMPLOYEE SEARCH

Members of our firms have over the years had the opportunity to conduct multiple organizational/management studies. Most of these are at the behest/requirement of the regulators, but some are simply because the board is proactive and would like an outside look at the management of the organization.

In connection with one of these studies recently, we had an interesting conversation with one of the executive officers about attracting new personnel to their bank, and particularly their geographic location. This particular individual recounted the evolution of the changing labor market. The comment was basically a couple years ago potential candidates for employment would make appointments for interviews and wouldn't even bother to show up. That subsequently evolved to individuals making appointments for interviews, showing up for the interviews, agreeing to the terms of the job, and then not showing up for work. The general comment was the evolution further continues so that now they actually show up for work, find out what the job is like, and often leave quickly. The comment was the executive hopes this continues to evolve back to where the bank can obtain some reasonably talented potential long-term players. Interesting perspective on the labor market for this particular organization.

THOSE DARN KIDS

We have recently had a couple of different discussions related to younger employees. One of these discussions was in the context of a strategic planning session. A portion of the discussion at the session was dedicated to employee succession and talent development. During this part of the discussion, one of the participants, feeling somewhat exasperated about the bank's younger employees, reflected that they "feel like they are parenting someone else's child." We recently heard a similar sentiment expressed, when we heard someone bemoaning the fact that one of the first things that must be done when hiring young employees is spending a couple of weeks teaching them personal skills, such as how to shake someone's hand and look them in the eye.

We are not trying to debate the merits or efficacy of these statements. Instead, we are passing along what seems to be somewhat of a sentiment of frustration among many community bankers. These recent comments are not the only time we have heard this point of view. We have heard numerous different times about the perceived shortcomings of the next generation of community bankers.

Our belief is that you cannot paint with too broad of a brush. No doubt there are somewhat younger community bankers that are in need of professional development. No doubt there are others that are superstar leaders with great personal, business and analytical skills that will do wonders for their community bank. The hard part in today's environment seems to be recruiting and retaining more of the latter and less of the former.

MANAGEMENT SUCCESSION

We have often reported in Musings on management succession issues, both good and bad. Every board of directors to appropriately exercise its fiduciary duty needs to plan for management succession, particularly the CEO slot. Although apparently a mouse can be cloned now so that they can look like a wooly mammoth, the bank board still cannot clone its existing CEO to obtain a new CEO. The better approach is to determine what characteristics your bank needs in a CEO, who is available, and how best to obtain that individual. The goal is to follow an appropriate process. Also, sometimes although it is more expensive, the process may involve the use of an independent third party headhunter or something similar.

INDEPENDENCE STRATEGY

Most of our clients around the country espouse a strategy of remaining independent over the long term. We indicate to them that independence is not a condition, it is an action and action needs to be taken to make sure the bank remains independent. Three basic categories of actions need to be discussed and planned for. First, board of directors succession. Frankly, we worry less about board of directors succession as it relates to independence. If your community bank board has 10 directors and two of them retire, then it is easy to replace those two and move on. The next issue is management succession. As noted above, it is absolutely critical. The third issue, and perhaps the most important with independence, particularly for the closely-held bank, is ownership succession/transition. If your bank or holding company is closely-held and the ownership is not transitioning effectively to the next generation, then it is a problem. By "effectively" we mean transitioning to the next generation where when they receive the stock upon the death of the current generation, they actually want to hold onto it and keep the bank independent, serving its community. One great way to do that is to make sure the stock maintains a significant cash flow to that next generation of shareholders.

LEVERAGING A HOLDING COMPANY

We recently have been with the boards of directors of a couple of bank holding companies which have never borrowed money at the holding company level. That's right – never. Generally, one of the benefits for a community bank holding company is the ability to leverage (i.e., borrow money at the holding company) to generate cash at the holding company, and either inject that cash into the bank as capital to be able to grow deposits and subsequently grow the loan portfolio, or simply use it for corporate purposes at the holding company typically to buy back shares or acquire another line of business or something similar. Every holding company should consider the ability to leverage as one of the many tools they have to enhance shareholder value. The only issue we have run into on occasion is when the holding company consists of "more mature" board members who do not borrow money in their own personal life/business and do not have the appetite for the risk associated with borrowing money at the holding company level.

Although we view the risk as manageable, the general risk is that the bank stock lender to the holding company will typically (unless it is an individual) require 100% of the bank stock to be pledged to the holding company loan. Theoretically, if the holding company loan was not repaid, the bank stock could be foreclosed on. That rarely happens even in bad times, including the last Great Recession. Consider leveraging your holding company for an appropriate purpose.

DIRECTORS AND OFFICERS INSURANCE

We have recently been with a couple of bank senior executives who questioned whether their banks should continue to maintain directors and officers insurance. It certainly seems like a no-brainer that they should, until the executive shed further light on the facts. One of these banks had 10 directors, all shareholders, all insiders, and all collectively owning 100% of the stock. The question was, do you really need D&O insurance when all your shareholders are on the board?

Directors and officers insurance, of course, protects directors and officers from suits by their shareholders, fees associated with those suits, and any ultimate judgment. Having dealt with numerous inter-board squabbles over the years, our recommendation is still to maintain the D&O insurance even though the bank may consider the chance of failure as remote, and the likelihood of a claim or an inter-board squabble as remote also. Our suggestion is to look at the coverage of the insurance (including all riders and exceptions) versus the cost of the policy. We anticipate in most cases community banks will assume the cost is worth covering the risk, no matter how slight the risk.

THE APPRAISAL CONUNDRUM

We recently encountered another iteration of what we would not describe as a common situation, but not one that is unheard of either. In this situation, our client engaged a third-party valuation expert to determine the fair market value of their holding company stock. Consistent with most appraisal processes, our client had a number of discussions with the third-party expert and thought they had a pretty good handle on the expert's methodology and anticipated results of the valuation. Unfortunately, that did not turn out to be entirely correct. The valuation came in materially lower than anticipated, which has resulted in a couple different specific problems.

The client called and asked our advice on the situation. Our first recommendation was to go back to the valuation expert and talk through the valuation, noting the appropriate objections. We assisted the client in reviewing the valuation, and we think there are a number of spots where the valuation expert could handle things differently to arrive at a different conclusion. Secondly, we recommended the client give consideration to disclosure. The existence of the valuation creates disclosure issues if the holding company uses a fair market value for the common stock that is different than the valuation. Simply put, insider trading considerations require the appropriate disclosure of all facts known by a party that may be material to the decision on whether to effect a transaction. If the shares were to be sold or purchased by the holding company at a price that exceeded the fair market value (in the case of a sale) or was lower than the fair market value (in the case of a purchase) as determined by the independent appraisal, we see a compelling argument that disclosure of the appraisal needs to be made to the counterparty.

WAITING IS THE HARDEST PART

A long-time outside director recently made what we saw as a humorous and insightful comment. During a discussion regarding the individual's position as an outside director, the individual commented that when they joined the board, they were told that the bank was going to do all kinds of great things, certain changes were going to be made and new blood was going to be brought onto the board. That comment was immediately followed by a clarifying comment, which was "that was 25 years ago, and we are still waiting to see it happen!" The outside director grinned and smiled, but in a way that made us believe there was more truth to the statement than might be ideal.

The comment was humorous. It also was not a total joke. We suspect there was a healthy infusion of truth into this statement, because we have seen such circumstances a number of times.

As a board, we think it important that you challenge yourself to a different way of thinking. We think it is healthy to question why things are done the way they are done, and what needs to change in order to ensure your community bank maintains ongoing relevance. If the board is doing anything the same as it did 25 years ago, we hope it very firmly falls into the category of a best practice. If it does not, our recommendation is to determine a better way to do it.

AN UNUSUAL CORRECTION

After the last *Musings*, we had an astute *Musings* reader (and also client and friend) comment that we weren't exactly right in one of the articles. We reminded him we have been known to be occasionally incorrect, but never in doubt. We had made a pretty much offhand smart aleck remark that the FDIC's job was to protect the insurance fund (i.e., since it was their money, they were looking after it better than the other friendly federal regulators). This banker clearly pointed out to us that it is not the FDIC's money - it's the banks'. And on top of that, the FDIC cavalierly spends it like insuring all the deposits at Silicon Valley and Signature. Point well taken. We do want to note this is the first time we have printed any kind of correction in over 20 years. It's not that we haven't been wrong – we just haven't printed a correction.

MUSINGS LIVE

Yesterday was a historic day for *Gerrish's Musings*. At ICBA LIVE in Nashville, *Gerrish's Musings* was presented live and in person for the first time ever. At the session, we lifted the curtain on the drafting and editorial process for *Musings*, and presented some of *Musings*' "greatest hits" from past editions. For those of you that were in attendance, we very much appreciate you coming and spending some time with us. For those that were not there in person, please know that our central aim in drafting and distributing *Musings* is to educate, inform and entertain community bankers across the country. We have been doing so for approximately 23 years, and we appreciate very much those of you that take the time to read the words we enjoy putting on this page. We look forward to continuing to do so for many more years to come!

CONCLUSION

The end of the first quarter is nearly upon us. We still view community bank financial performance as strong with the only exception of some notable concerns in the agricultural sector.

Stay safe. See you in two weeks.

Jeff Gerrish *Philip Smith* *Greyson Tuck*

Upcoming Webinars and In-Person Presentations

- April 1, 2025 – Community Bankers Association of Illinois – Remaining Independent: Community Bank Directors' Conference, CBAI Headquarters in Springfield, Illinois. (Philip Smith and Greyton Tuck, presenters) Registration: [redacted]

- April 16, 2025 – Independent Community Bankers of America – Webinar, "Building a Better Community Bank Board" (Philip Smith, presenter) Registration: [redacted]

- April 24, 2025 – Independent Community Bankers of America – Webinar, "Family-Owned and Closely-Held Bank Strategies" (Philip Smith, presenter) Registration: [redacted]