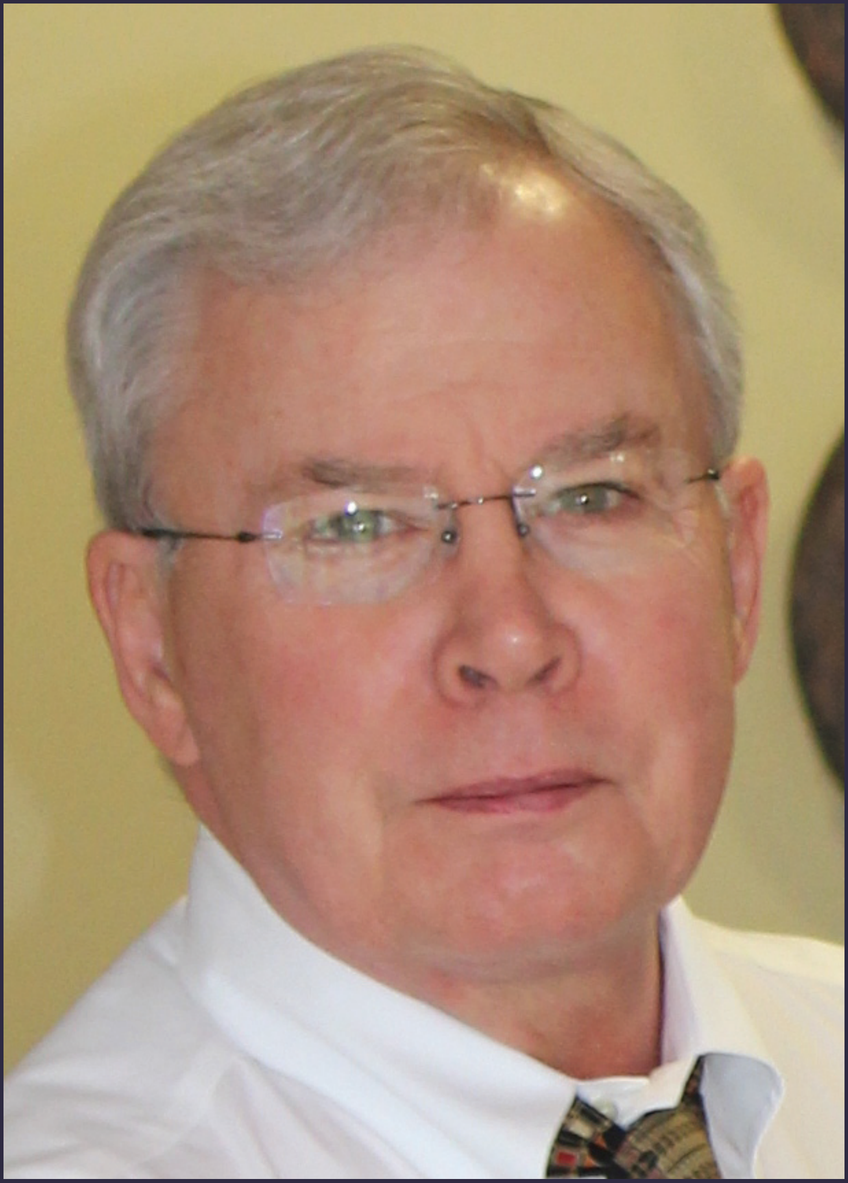
THE SHOW-ME BANKER

THE VOICE FOR MISSOURI'S INDEPENDENT BANKERS October 2016



Arthur Kniffen, President & CEO
Bank of Hillsboro
A Man With Many Qualities
(See article page 10)

MIBA Missouri Independent Bankers Association

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HOW TO REMAIN AN INDEPENDENT COMMUNITY BANK

By Elizabeth Fast, Partner at Spencer Fane LLP

It is important to most independent community banks that they maintain their independent status, rather than becoming a branch of a large financial institution. Many independent community bank (ICB) owners are thinking about what's going to happen to their bank when they retire. It used to be that the next generation of the family would step up to manage the bank when the older generation retired, but many of the younger generation aren't interested in living in the bank's community or in running the bank. Also, some shareholders may need cash or liquidity for various personal reasons and they see the sale or merger of the bank as the best way for them to get the cash that they need.

In the first part of this article, I'll tell you true stories about three Missouri banks that found creative ways to keep their banks operating as an ICB; and, in the second part of this article, I'll suggest actions you can take to ensure that your bank remains as an ICB.

The first story is about a bank that was 75 percent owned by a brother and sister who had inherited the stock from their father. The brother was the president of the bank and the sister was a director. Both were nearing 70 years old. None of their children or grandchildren lived in the community where the bank was located. These siblings knew that once they died, their heirs would sell their stock to the highest bidder. It was so important to these siblings for their bank to remain as an ICB within the community where they were born and raised that these siblings devised the following plan.

There was one officer who had worked at the bank for many years and he currently was a director. They knew this officer would be committed to maintaining ICB status for the bank, but this officer didn't have the financial ability to purchase such a large block of stock from the siblings. Plus, another senior officer for the bank would need to be hired when the president retired. The solution was to identify an officer at another ICB in a neighboring town who owned no stock at their current bank. The officer at the other bank was willing to relocate for the opportunity to become a senior officer and stock owner in this bank. The siblings sold their stock to these two officers by carrying back notes in a couple of phases, which was approved by the bank's regulators. It has been several years since this transaction occurred and the bank is thriving under the management of these two new owners of the bank who are committed to keep this bank as an ICB.

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In this next story, the bank was 85 percent owned by one individual. Most of the bank's officers were nearing retirement and there weren't any junior officers who appeared capable of stepping up to manage the bank at this time. The owner wanted to sell the bank but he wanted to ensure that the bank remained an ICB. The owner contacted a couple of other ICBs, which he respected, to inquire as to their interest in acquiring his bank. This resulted in the merger of his bank into an ICB in a neighboring town. The merger has worked great because the surviving ICB is still family-owned and being managed by the vibrant younger generation, which served as the succession plan for his bank's senior officers nearing retirement. Although his bank changed its name, it is still part of an ICB that is actively involved in his community.

This last story is about a bank that had several large shareholders. One shareholder owned about 35 percent of the bank. Although this shareholder didn't want to sell his stock, he needed cash for personal reasons, which meant that he had to sell. Rather than risk this large block of stock being sold to investors who lived outside of the community, the bank's holding company had enough capital to buy back some of its stock from this shareholder and existing shareholders were able to purchase the remaining stock from this shareholder. All shareholders benefited when the holding company bought back some of its holding company stock from the selling shareholder, and the existing shareholders who purchased stock from this shareholder were pleased to have increased their ownership in the holding company. The important thing is that this ICB is still owed by the same shareholders (except for the shareholder who needed to sell).

I'm sure you already realize that to remain an ICB, your bank must not be purchased by, or merged into, a large financial organization. Pursuant to Missouri law (if you are a state-chartered bank) and OCC regulation (if you are a national bank), the bank's board of directors and the bank's shareholders both are required to vote in favor of any sale or merger of the bank. At least a majority of the directors must vote in favor, and at least two-thirds of the shareholders must vote in favor. Thus, your obvious goal is to ensure that your bank's directors and shareholders are committed to remaining as an ICB.

1. Change bylaws to require a super-majority vote to approve sale or merger.

As stated above, the law requires at least a majority of the directors to vote in favor, and at least two-thirds of the shareholders to vote in favor, to approve a sale or merger. To make it more difficult to obtain the requisite director and shareholder approvals for a sale or merger, the bank's (or bank holding company's) bylaws could be amended to require a super-majority vote requirement before a sale or merger is approved. For example, the majority vote of directors could be increased to a two-thirds vote of directors, and the two-thirds vote of shareholders could be increase to a 75 percent vote of shareholders.

2. Replace directors who are not committed to keeping your ICB status.

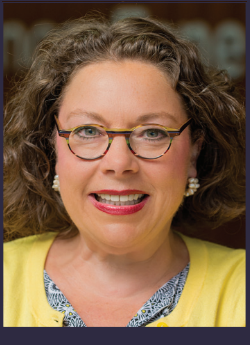
If you have a director who is not committed to keeping your ICB status, this director should be replaced. Shareholders elect directors so shareholders can remove directors. Although you could wait until this director's term expires, it is permissible to replace this director immediately by calling a special shareholders meeting. You will want to elect directors who have the same vision as you. Generally, local businessmen who care more about the best for the community rather than the best for his/her own pocketbook would probably be interested in keeping your bank independent.

3. Buyout shareholders who want to sell.

Even if you have only a few shareholders, it still may be difficult to convince all of your shareholders about the benefits of remaining as an ICB. If there are shareholders who are not devoted to the concept of remaining as an ICB, it would be beneficial if those shareholders could be bought out by existing shareholders who are devoted. Also, some shareholders may need cash or liquidity for various personal reasons so they may need to sell their stock. If would be beneficial if their stock could be purchased by existing shareholders, rather than be purchased by a new shareholder whose motives are unclear.

4. Right of first refusal agreement among shareholders

A right of first refusal agreement among the shareholders permits the holding company and/or existing shareholders to purchase shares being offered for sale before these shares can be sold to third parties. As a general rule, shareholders may freely sell their shares in a private transaction without your knowledge, and shareholders may sell their shares to third parties who eventually could aggregate enough shares to hold a majority vote. Obtaining a right of first refusal agreement among shareholders is an excellent method to keep the stock ownership within the existing group of shareholders. ■



If you have any questions or comments, please feel free to contact Elizabeth Fast at 816-292-8861 or efast@spencerfane.com.