

GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Florida, Tennessee, Washington State, Alabama, Idaho, New Mexico.

DO YOU KNOW THE SCOR?

Perhaps you think I have misspelled SCOR. I did not. Would it surprise you that the examiners may have "an agenda" when they come into your bank for an examination? They do, because they know the SCOR. The SCOR is the Statistical Camel Offsite Rating. This is a computer spewed out CAMELS rating sent to the examiner before he/she ever comes into your bank. It provides the examiner with such detail including a statement such as "it is a 93% probability that the bank's CAMELS rating will be downgraded. It is a 78% probability that the management rating will be downgraded." That's right! The examiners are given their marching orders before they ever walk in your door through receipt of the SCOR report.

We recently became aware of the SCOR report as a result of a client who was asked to execute, by consent, a cease-and-desist order. The client declined and wanted its day in court. We went to trial in an administrative hearing over a three-day period. Part of the process of that hearing involved document discovery from the regulators which produced the SCOR reports.

What do you suppose an examiner is going to do when he or she gets a document from the Washington office that says the probability of a downgrade of your bank is greater than 50%? He is going to downgrade your bank!

DIRECTOR EDUCATION

Director education, while optional in the past, is basically becoming mandatory. One state in the country has mandated for all the state-chartered banks that directors must get continuing education if they desire to continue to sit on the Board. Banks are setting up proprietary seminars, bringing in speakers, sending the directors out, establishing budgets and the like. We are not advertising this necessarily, but our firm is doing a lot. The point is not who you use, but that it gets done. Be proactive in this regard and on other corporate governance issues.

FUTURE OF COMMUNITY BANKS

FDIC recently published in its FDIC Banking Review an article complete with tables (totaling 56 pages) trying to answer the issue of “Is there a future for community banks?”. The bottom line and good news is, as concluded by the report, “Community banking (defined as banks less than \$1 billion in assets), therefore, appears to be a viable business model.”

If anybody would like a copy of this, it is available on the FDIC’s web site at www.fdic.gov/bank/analytical/banking/2005jan/article1.html.

INDEPENDENT COUNSEL

Publicly reporting companies under Sarbanes, through their Audit and other special committees, have the option of retaining independent counsel. I recently ran across a situation (and an interesting article) promoting the use of regular (as opposed to “occasional”) independent counsel for these committees. The theory of the article is that if your independent counsel is involved with the outside directors regularly, counsel is likely to do a better job.

DIRECTOR RESIGNATION POLICY

In recent discussions with a Musings subscriber, I was advised that his bank has a “director resignation policy”. Although I have seen mandatory director retirement clauses in charters, bylaws and the like (most honored only in the breach) and certain director qualification policies, I have not before reviewed a director resignation policy. The policy basically sets forth certain criteria under which the director agrees in advance, should these criteria come into

existence, e.g., bankruptcy, classified loan, etc., that he or she will resign from the board. Although it is probably not a legally enforceable document, it seems to me it is a good idea. If anybody wants a copy, please let me know.

FAIRNESS OPINIONS IN ACQUISITION TRANSACTIONS

The National Association of Securities Dealers (NASD) is finally waking up to the inherent conflict of interest in a transaction where the investment banker serves as both the financial advisor to the buying or selling company (thereby getting a large advisory fee) and renders the fairness opinion that says the transaction is fair. NASD is proposing rules that would at least require the renderer of a fairness opinion to disclose the inherent conflict. As most of you know, a fairness opinion is simply an opinion rendered by an outside financial expert in connection with a transaction that the terms of the transaction are fair to the shareholders from a financial point of view. Our firm has recognized this inherent conflict for years which is why, although we serve as financial advisors on transactions, we do not render fairness opinions in the same transactions. The new NASD contemplated rule will not prohibit this conflict, but it will simply require that it be disclosed. I suppose that is a small step in the right direction.

INTERESTING BANK SECRECY ACT TWIST

We have a client that was recently examined by the regulators. It had been a 3-rated bank subjected to a board resolution (the least offensive regulatory corrective program). The bank has improved since the last examination and during the current examination which just concluded, they have been advised that the CAMELS rating will be upgraded from a 3 to a 2. It sounds like good news doesn't it? However, instead of terminating the board resolution, the regulator is now requesting a memorandum of understanding (a step up in enforcement actions) because of, guess what, Bank Secrecy Act issues. These are very, very hot buttons with the regulators and they have got to "paper" anything they find. Keep your guard up!

GOING-PRIVATE?

A number of Musings subscribers are public companies. You may have considered becoming a private company. Don't do what one small Minnesota public thrift holding company recently did. They tried to go private through a dutch auction to their shareholders. In other

words, a voluntary transaction. I hate to break it to you, but you are not going to get your shareholder base significantly reduced, no matter how high a price you pay, through a voluntary means. The only way you can go private (or in most cases, form a Sub S for that matter) is through some kind of a forced transaction, either a reverse stock split, followed by a forward stock split, or a cash merger.

CONCLUSION

As most of you know, I have a book out entitled The Bank Directors' Bible: Commandments for Community Bank Directors. I recently published a second book entitled Gerrish's Glossary for Bank Directors. This is basically a serious but also slightly irreverent look at many of the basic terms bandied around in boardrooms. At 128 pages, it should be enough for anybody. If you are interested, email my secretary, Linda, at ldandridge@gerrish.com.

Sincerely,

Jeff Gerrish

SAMPLE