

Strategies for Ownership Succession Planning



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Ownership Succession Planning - Agenda

- Overview
- Options for ownership succession planning
- Management succession
- Consulting with Advisors

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Ownership Succession Planning - Overview

- Overall process to discuss, identify and develop strategic options for continued or enhanced performance and leadership of an investment
- Long-term plan
- Articulates and manages the strategic goals
- Establish policies
- Identify and transition responsibilities to successors

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Ownership Succession Planning - Overview

- Process
 - Determine stakeholders and social contracts
 - Lay out expectations and priorities
- Considerations of objectives and strategies
 - Business
 - Financial
 - Emotional
 - Personal

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Ownership Succession Planning - Overview

- Time is NOT of the essence
- A successor will evolve
- Equal is fair (equitable is not necessarily equal)
- It's easier to just sell or merge
- Ownership succession equals losing control and income

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Options for Ownership Succession Planning

- Buy
- Sell the Investment
- Hold the Investment

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Ownership Succession Planning – Buy/Merge

- Reasons to buy/merge
 - Strong leadership team in target
 - Financial performance
 - New markets - growth
- Expectations of buy/merge
 - Whole is greater than sum of parts
 - Sustainable model and business plan
 - Future growth and value
- Considerations of buy/merge
 - Capital needs - future liquidity events - growth
 - Shareholder agreement
 - Pricing

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Ownership Succession Planning - Sell

- Reasons to Sell
 - LACK OF ADEQUATE SUCCESSION PLAN
 - Business model not sustainable
- Expectations of Selling the Investment
 - Quantitative
 - Non quantitative
- Considerations of Selling the Investment
 - Financial
 - Emotional

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Ownership Succession Planning - Hold

- Reasons to hold the investment
 - ROE exceeds that of alternative investments
 - Dilutive effect of income taxes
 - Keep the investment in the family (children involved)
 - Sustainable model for growth and profitability exists
 - Estate planning
 - Investment or Bank is not in a position to be sold

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Ownership Succession Planning - Hold

- Reasons to hold the investment
 - Bank is an appreciating asset
 - Strong management depth and capability
 - Market area provide for growth and profit opportunities
 - Pricing is increasing

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Ownership Succession Planning - Hold

- Expectations of holding the investment
 - Increase in shareholder value
 - Dividends to cover taxes
 - Liquidity needs are met
 - Strong management

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Ownership Succession Planning - Hold

- Considerations of holding the investment
 - Transferring ownership to the next generation
 - Gifting
 - GRATS
 - Voting vs non-voting stock
 - Stock redemptions
 - Change in control considerations
 - Optimal tax structure
 - ESOP

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Ownership Succession Planning - Hold

- Gifting
 - Easy to accomplish
 - Future Income and appreciation are removed from the estate
 - Disadvantage is no step up in basis upon death
 - Life time exclusion for 2018 is \$10,000,000, indexed annually for inflation
 - Annual gifting exclusion for 2018 is \$15,000

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Ownership Succession Planning – Hold GRAT Illustration

The diagram shows the following flow:

- Grantor** (represented by a circle) transfers **1. Assets** to the **Grantor Trust** (represented by a triangle).
- The **Grantor Trust** provides **2. Annuity Interest** back to the **Grantor**.
- The **Grantor Trust** transfers **3. Remainder Interest** to the **Children/Beneficiary** (represented by a rectangle).

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Ownership Succession Planning - Hold

- Grantor Retained Annuity Trust (GRAT)
 - Grantor trust is irrevocable
 - Transfer income and/or growth assets to the trust in exchange for an annuity
 - Taxable gift on formation is equal to the excess of the value of the assets transferred less the present value of the annuity retained
 - The annuity is based on the 7520 rate which is set by the IRS (3.2% in April 2018)
 - Income and growth in excess of the 7520 rate and potentially the value of the discount on certain assets are transferred to beneficiaries free of transfer taxes
 - Disregarded for income tax purposes
 - If trust assets appreciate greater than IRS prescribed rates and you outlive the term of the trust, excess growth and income passes to the trust beneficiaries transfer tax free.

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Ownership Succession Planning - Hold

- Grantor Retained Annuity Trust (GRAT)
 - Income tax is paid by grantor and is in effect a non-taxable gift to the trust
 - Benefiting the trust beneficiaries
 - Reducing the grantor's estate
 - Potential Risk - Assets decrease in value
 - Potential Risk - Insufficient cash flow requiring appraisal of trust assets to make annuity payment

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Ownership Succession Planning – Hold

- Voting/Non-Voting Stock
 - Retain control yet gift significant equity position
 - Federal Reserve requires the voting capital to be greater than fifty percent

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Ownership Succession Planning – Hold

- Stock Redemptions
 - Means of providing liquidity to individuals selling BHC stock, also increases ownership percentage of remaining shareholders
 - Qualified under 302(b)
 - Disqualified under 302(b)
 - Qualified under 302(b)
 - “Sale” or “Exchange” treatment....generally results in long-term capital gain (or loss)

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Ownership Succession Planning – Hold

- Stock Redemptions
 - Qualified under 302(b) (cont'd)
 - Termination of entire interest and involvement in corporation
 - Ownership test – post redemption less than 80% of ownership pre-redemption, only if own less than 50% total through attribution
 - Attribution rules waived if termination of entire interest

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Ownership Succession Planning – Hold

- Stock Redemptions
 - Federal Reserve Considerations
 - May need Federal Reserve advance approval
 - Greater than 10% rule
 - SR 09-4 – Section on Redemptions

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Ownership Succession Planning – Hold

- Stock Redemptions
 - Disqualified under 302(b)
 - Added benefit if S corporation
 - Treated as a regular dividend
 - If sufficient basis, no current capital gain
 - If C corporation may not be desirable income based on the dividend tax rate when received.

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Ownership Succession Planning – Hold

- Optimal Tax Structure
 - S corporation vs C corporation
 - Reassess these structures annually with tax law changes – Tax Cuts and Jobs Act
 - Reassess these structures based on ability to make distributions.

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Ownership Succession Planning – Hold

- Employee Stock Option Plan
 - Management ownership through plan along with all other eligible employees
 - Creates a liquid market for bank holding company shares
 - Very powerful in S corporation structure

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Management Succession

- Structural process to ensure leadership continuity
- Requires collaboration between Board, incumbent executive team and key management members
- Should address:
 - Emergency succession planning
 - Executive team succession planning
 - Retention of management

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Retention of Management

- Make them part of the plan, listen to input, increase their responsibility and involvement in decision making
- Recognition of management contributions
- Offer deferred compensation arrangements, incentives and fringe benefits
 - Nonqualified plans – deferred compensation plan
 - Split dollar life insurance

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Consulting with Advisors

- Benefits of using outside advisor consultant
 - Role and responsibilities of advisor
 - Neutral third party
 - Identifies the participants and interviews them (one on one)
 - Sets the stage for open forum and confidentiality
 - Asks the tough questions
 - Establish time frame
 - Keeps the process moving ahead

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Consulting with Advisors

- Goals or objectives of process
 - Establish a level of trust
 - Openly identify all issues
 - Share ideas
 - Define leaders and leadership roles
 - Agree that if we disagree, alternatives will be explored

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Consulting with Advisors

- Outcomes/develop the plan
 - Leadership and management
 - Naming successors
 - Timing
 - Use of personality and profiling tools
 - Develop team building processes
 - Communicate plan to employees
 - Identify any trust issues during implementation
 - Keep plan on track

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Consulting with Advisors

- Accounting and legal advisor considerations
 - Executive agreements
 - Deferred compensation arrangements
 - Non competition agreements
 - Purchase and sale agreements
 - Change in control
 - Estate planning documents
 - Due diligence
 - Proforma financial statements
 - Structure for tax benefit
 - Tax effect of sale


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Thank You!



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