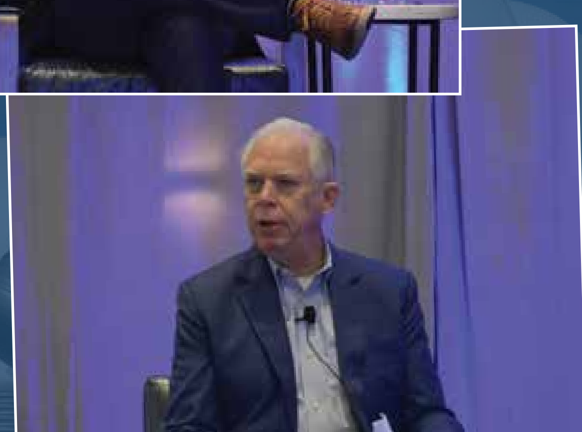
theBHCA.org — Winter 2024

Bank Owner

Bank Holding Company Association Magazine



MARKETPLACE OF IDEAS

Fall 2024 Seminar Coverage

Annual Meeting Report

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Bank Owner

Winter 2024

The Bank Holding Company Association exists to provide education and business connections critical to the vitality of bank holding companies.

Founded in 1981, the BHCA welcomes Members from around the country. Holding companies of all sizes from throughout the Midwest make up a majority of the current membership. Companies that serve bank owners, their holding companies and banks, are welcomed as Associate Members.

The *Bank Owner* magazine is the quarterly publication of the BHCA. The magazine is your best source for BHCA information, including upcoming events. Members receive the magazine in the mail and have access to an online version at theBHCA.org. Managing Director Tom Bengtson serves as editor. Contact him at (952) 835-2248 ext. 101 or email us at Tom@thebhca.org.

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BHCA
BANK HOLDING COMPANY ASSOCIATION

www.theBHCA.org

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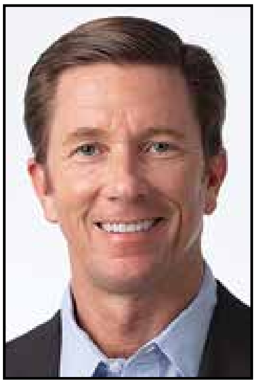
New to BHCA

The Bank Holding Company Association is pleased to welcome the following new Associate Member:

Saturn Partners, Inc. | Carole Crawford, Founder
Forest Lake, Ill.

Saturn Partners offers specialized cybersecurity services for the financial sector, including community banks. The company performs complete cybersecurity plan development, security awareness training for the front lines, and social engineering vulnerability and risk assessments. Services can be bundled or scaled to fit any bank. The company started in 2001, writing network security policies for banks facing the new GLBA regulations.

It was an honor to interview the Mpls Fed Bank President



By John Healey
Crown Bankshares
Edina, Minn.

It isn't every day you get to interview the president of the local Federal Reserve Bank in front of a couple hundred industry colleagues. I got the opportunity on Oct. 7, the first day of our Fall Seminar, to spend 53-and-a-half minutes on stage immediately after lunch asking questions of Neel Kashkari, who is in his ninth year as President of the Minneapolis Federal Reserve Bank. Mr. Kashkari is very impressive and I truly enjoyed the opportunity to share a conversation with him.

In total, I got to ask nine questions touching on things such as commercial real estate, the Federal Reserve balance sheet, and of course interest rates as our dialogue took place a few days after the FOMC agreed to lower rates by 50 basis points. He told us he joined the majority of the committee members in favor of this reduction.

In addition to moderator questions, 11 people from the audience asked questions, probing things as varied as how his background in aerospace helps him as a Fed bank president, to education research, to the impact of immigration on housing, to the yield curve.

Mr. Kashkari, who is a very articulate speaker, answered all of our questions with grace. He even got a big laugh when he noted that all bankers tell examiners that their own banks lend conservatively, "but you should examine the bank across the street and see what they're doing!"

I also had to chuckle at Mr. Kashkari's answer when asked what he does to unwind and he said he rarely gets to relax. "I have a son who is nearly 4 years old and a 5-and-a-half year old daughter, so I never get away from stress," he said. "What I get to do is exchange one kind of stress for another."

When the conversation turned to his time working for the U.S. Treasury Department, Mr. Kashkari noted there is a play running in town about Lehman Brothers. He was correct in that the Guthrie Theater at the time was presenting The Lehman Trilogy, but the run concluded on Oct. 13. I am betting, however, that if you really wanted to see it and were willing to travel you could probably find a production of it somewhere. The play won five Tony awards on Broadway, including Best Play in 2022.

There was also some discussion about artificial intelligence, and if you are not very familiar with it, I encourage you to check out Google Gemini at gemini.google.com to experience the rapid fire power of AI. I use this service several times a day and find it quite useful.

While the session on stage lasted nearly an hour, it went very quickly, or so it seemed to me and I hope it seemed for you as well. I actually had about 30 questions prepared – if we had the time, we could have gone on much longer.

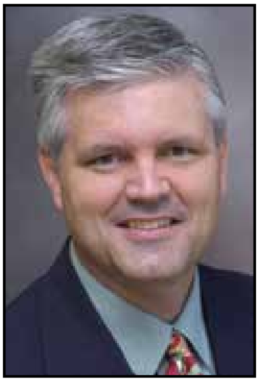
This was certainly a team effort. I wish to thank Tom Bengtson, the BHCA's Managing Director, for providing his communication and media expertise in practicing the interview and for securing our esteemed guest.

If you were not able to attend the seminar, or if you would like to view a recording of the interview, search YouTube for "Kashkari BHCA." We don't typically videotape our BHCA sessions, but the Federal Reserve Bank, under Mr. Kashkari's leadership, is making transparency a priority and is therefore live-streaming his public appearances and posting the video where everyone can see it.

I want to close by thanking all those who attended the Fall Seminar. Both our seminars this year were big successes and I hope you were there to experience them. The year has gone very

President's Observations, *Continued on page 7*

A marketplace of ideas shared at Fall Seminar



By Tom Bengtson
BHCA Managing Director

We called out Fall Seminar a "marketplace of ideas" and I hope that you found it to be just that. I think we covered a lot of topics in seven general sessions and three breakout sessions. More than 240 people registered to attend – that's a post-pandemic high. If you were in that group, thanks for coming out and making it a great seminar; if you weren't in that group, then I invite you to make a point of coming out to our seminars in 2025.

We are fortunate to have people like Tony Moch of Winthrop & Weinstine, John Reichert of Reinhard Law, David Heneke of CLA, Gary Svec of Performance Trust, Craig Mueller and David Stieber of TruStar Advisors, Scott Coleman of Ballard Spahr, and companies such as Forvis Mazars, Wipfli and CBIZ who have presented and/or supported our Fall Seminar many times in the past. Our pool of Associate Members is a tremendous resource and when they work together through the BHCA, we can all present an unparalleled seminar experience.

And I want to take a moment to acknowledge the two bankers who participated in Scott Coleman's "unique partnerships" panel. Steve Lindholm has been involved in several M&A transactions during his career and I appreciate Scott asking Steve about the details of some of those deals, particularly the most recent one which involved the acquisition of a bank in another state. But even more compelling was Kelly Rachel's story about how Stutsman County Bank became Unison Bank when multiple holding companies came together to buy the bank. It is an interesting example of how a bank might establish a presence in a market that it might otherwise consider to be too big to handle.

Our banker panels often end up being the most interesting portion of our seminars. Nothing beats first-hand experiences shared by the bankers who actually lived through them. And some of these matters are highly personal, so I don't take it for granted that these bankers are willing to share. They are truly providing a valuable service.

I also want to take a moment to thank our breakout session presenters. The session on fraud prevention received particularly positive feedback, and I think that is because fraud is so pervasive in financial services these days. Technology makes banking services convenient and efficient, but it also opens the door to new kinds of trouble. I suspect we will have more sessions on fraud and fraud prevention at future seminars.

With Federal Reserve Bank of Minneapolis President Neel Kashkari opening our seminar and economist Elliot Eisenberg closing our event, we heard from two highly respected experts about the economy. I think just about everyone has an opinion on the economy, where the trouble is, and what might happen in the coming months, so it is always good to get some different points of view against which we can assess our own thoughts. Both presenters had addressed our group previously; I think the familiarity between audience and presenter in both cases made for particularly effective presentations.

We are committed to presenting two seminars per year, so if you have thoughts about topics you would like to see addressed in 2025, please email me at Tom@theBHCA.org with your thoughts. Go ahead and mark your calendars now for our Spring Seminar, set for May 5-6 and our Fall Seminar, scheduled for Oct. 6-7. May 6 will include our third annual awards leadership luncheon so make plans now to invite some of the rising stars in your organization to join you for an inspirational event.

New Board Members Elected

At the BHCA annual meeting conducted at the Fall Seminar on the morning of Oct. 8, membership voted to change the BHCA bylaws to allow for the expansion of the 10-person board of directors to 12, with the additional seats designated for BHCA Associate Members. This is the first time since the organization was founded in 1981 that Associate Members have been included in board representation. BHCA President John Healey of Crown Bankshares in Edina, Minn., advocated for the change earlier this year.

In the spring, we publicized the pending change in the bylaws to allow for Associate Member board members. All Associate Members were invited to a webinar in which the proposed change was explained, and in the previous edition of this magazine, I encouraged interested Associate Members to put their name in for application.

We received eight applications by the mid-September deadline. The board then considered each of the applications and conducted a discussion via conference call about two weeks prior to the annual meeting, in anticipation that the bylaws change would be approved. Associate Member board seats are for two years, with one coming on the board and one going off each year beginning in 2026. As we enter 2025, the board decided to nominate one candidate for a full two-year term and another for a special one-year term. Based on the conference call discussion, the board selected Scott Coleman of the Ballard Spahr law firm in Minneapolis to fill the two-year seat and Sean Raboin of HTG Architects in Hopkins, Minn., to fill the one-year seat. Candidates needed to be BHCA Associate Members for at least five years to be considered. Selections were

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Minneapolis Fed's Kashkari joins bankers, takes questions at BHCA Fall Seminar

By Jackie Hilgert

Neel Kashkari, president of the Federal Reserve Bank of Minneapolis, fielded bankers' questions on a variety of topics in a packed opening session of the Bank Holding Company Association's 2024 Fall Seminar. BHCA President John F. Healey, president of Crown Bankshares, Edina, Minn., welcomed Kashkari to the stage and moderated the nearly hour-long conversation, which was live streamed by the Fed.

Kashkari talked about interest rates, of course; his visit came less than three weeks after the Fed approved its first rate drop in a year when roughly seven had been predicted; the first lowering since 2022. Kashkari defended the move: "The balance of risks have shifted away from high inflation toward maybe higher unemployment. And that's why I thought dialing that policy was the right move."

Beyond sharing his insights on monetary policy and his role as a voting member of the FOMC, Kashkari responded to queries about regulatory burden, overnight access to capital, and his involvement in education research.

Federal Reserve Bank of Minneapolis President Neel Kashkari at the 2024 BHCA Fall Seminar.

Small Banks; Outsized Burden

In a room filled with commercial bankers, Kashkari was asked to weigh in on commercial real estate as a burgeoning problem for lenders. "Obviously the office sector is the one that I think most people are paying closest attention to … and I think the shoes to drop from that have not yet fully dropped," he said.

Yet CRE lending is a broad category and one Main Street banker asked if the Fed has plans to differentiate the type of CRE lending he and his peers do from the CRE lending that encapsulates skyscrapers and office developments in urban centers. Specifically, he mentioned examiners pressuring banks on the 300 percent CRE supervisory limit.

"I talk with your staff about this all the time," the banker said. "My CRE is not the CRE you're talking about. I'm not financing IDS buildings and office towers. I wonder if you'll talk a little bit about the difference between those two and if there's any plans from a regulatory standpoint for the Federal Reserve System and the Ninth District to start differentiating between those two. It is not the same CRE that the Federal Reserve talks about more broadly through supervisor letters and even in the outreach events."

In his response, Kashkari didn't open any doors: "We want our bank examiners to be in dialogue with the banks that they're supervising. To understand, go under the covers, look at what these actual loans are, what these assets are, to understand what is associated with it," he responded.

Kashkari said he was unable to speak to specifics but encouraged open conversations between bankers and their regulators. "Do what you're doing and if you need to raise things up the flag pool, raise things up the flag pool," he said, hinting that bankers may not receive any more satisfaction should they actually do this. Now in his ninth year at the Fed, Kashkari said his most frequently heard comment from bankers was: "'We're very conservative, but you wouldn't believe what the other banks in my town are doing.' Every banker says that at every bank," Kashkari quipped. "So, we take the feedback; we want to look underneath the covers, to actually be judged."

Discount Window

Since the trio of bank failures in early 2023, discussions about liquidity, and accessing funding through the Fed's Discount Window versus advances from the Federal Home Loan Banks has become top-of-mind, said one longtime banker. He asked Kashkari if the Fed wanted or planned to change its approach to providing liquidity.

"I haven't heard anybody say that we want the Fed to be competing with the Home Loan Banks, trying to take market share," Kashkari said. "I think a lot of my colleagues and I are looking at a lot of different things to understand if there are structural barriers that prevent people who would otherwise want to access the discount window from accessing it?

"When Silicon Valley Bank got into trouble, one of the things we learned is there were a bunch of banks that in theory would like to have been able to tap the Discount Window, weren't prepared to do so. Either they didn't have the legal documentation in place or they didn't have the collateral available, or in some cases, they didn't know where their collateral was.

"You wouldn't think these would be real barriers, but in the moment they ended up being real barriers," Kashari added. "We've been trying to encourage all the banks to make sure they are prepared to actually access the Discount Window, that they have collateral available, that they know where it is, that they're in a position to pledge it so they can access it if they need it."

Limits, Outcomes of Fed Research

The Minneapolis Fed has for 20-plus years conducted research into early childhood education. Clarifying that its research focuses on the economic return on investments in early childhood education, Kashkari said the research ties directly to the Fed's dual mandate of achieving stable prices and maximum employment. "There's a lot of research trying to understand what are the drivers of maximum employment, and what does maximum employment even mean?" he said. "If we have research expertise that can bring it to bear, we're going to do so."

While Kashkari admitted the Fed doesn't set education policy, he defended the bank's "dispassionate research on important topics," he added. "The goal is to issue findings and leave it up to elected officials to act in response."

Yet one banker pointed out that in 2020, Kashkari teamed up with Minnesota Supreme Court Justice Alan Page to advocate for a constitutional amendment to change how education would be defined in the state. "That goes beyond just research," the banker said. "That's public policy; that's advocating a position in government, which is not the charter of the Federal Reserve.

"I worry that the independence of the Federal Reserve's going to be hurt by taking public policy issues," the banker said. "Research is great, but going ahead and advocating for a position like a constitutional amendment is a public policy decision that the politicians and the voters should make, not the Federal Reserve."

"You're right," Kashkari admitted. "Ultimately it's up to the state legislature to decide whether or not to take that forward, and up to the voters whether or not to take that forward."

Citing another example of Fed expertise in economic research, Kashkari said the Ninth District bank is also studying the economic impact of a minimum wage increase to $15 an hour in the cities of Minneapolis and St. Paul, Kashkari said, in response to those cities' requests. "This is a contentious issue where the labor community is on one side and the business community is on the other side," he said. "They came to us because they said, 'We think you're the only research group and everybody will trust you to do the analysis.'"

Having gained access to confidential state taxpayer data, the Fed is involved in a multi-year research study. "We're not saying that raising a minimum wage is a good idea or a bad idea," Kashkari said. "We're simply saying what the effects are."

On the flip side, the Minneapolis Fed has not conducted research on climate change issues, Kashkari said, though it seems clear these also have economic impacts.

"Some people push back on us, by the way, and say, 'you shouldn't even do the research," Kashkari said. "Ultimately, it's a judgment call on what we think is appropriate, what we think is within our mandate." ■

BHCA President John Healey interviews Neel Kashkari.

Want to watch the entire interview? Scan this code:

President's Observations, *Continued from page 4*

quickly and my one-year term as BHCA president is drawing to a conclusion. In addition to the seminars, we made an important change to our bylaws this year which results in an expansion of our board of directors, including Associate Members for the first time. I think this is a good move as we are grateful to all of our Associate Members, and the BHCA and its membership will benefit from it for a long time.

Thank you very much to my fellow board members, and to all BHCA members, for making 2024 a year to remember. Best wishes on the remainder of your year and I look forward to connecting with you again at a 2025 BHCA event. ■

Unique partnerships session gives bankers ideas for growth

By Jackie Hilgert

Scott Coleman of Ballard Spahr brought two bankers to the stage on the second day of the Bank Holding Company Association's 2024 Fall Seminar to share the unique ways they've grown their institutions, by taking seats on both sides of the negotiating table. Kelly Rachel, President and CEO of North Star Holding Company, Jamestown, N.D., parent of Unison Bank, and Steve Lindholm, Independent Bancshares, Inc., Excelsior, Minn., parent of FM Bank of Waseca, Minn., and Quoin Financial Bank of Miller, S.D., retraced their institutions' growth trajectory.

Unison, founded in Jamestown in 1965 as the Stutsman County Bank, was on the market at the turn of this century. "It was a wide ownership group through the years," said Rachel, who has worked at the bank the entirety of his 40-year career. "They did a squeeze out, brought it down to about five families, those families were aging, and in 2002 it was time to sell."

Rachel was chief credit officer at the time, showing the bank to potential buyers. "Our president at that time had ownership in another bank within the state of North Dakota, and he brought in two other organizations and got the deal done," Rachel explained. That deal involved three other North Dakota bank holding companies buying Stutsman County Bank, which was larger than each of the three individual acquiring banks. It was then, and remains now, a unique sort of deal, one that resulted in benefits for the purchasing banks.

Stutsman became Unison in 2006.

One benefit revealed itself this year, when Security State Bank of Wishek, N.D., sold their bank to North Star Holding Company. Wishek Bank Corporation was one of the three original acquirers of Unison.

Scott Coleman (center) of Ballard Spahr interviews Kelly Rachel (right), President and CEO of North Star Holding Company, Jamestown, N.D., and Steve Lindholm of Independent Bancshares, Inc., Excelsior, Minn.

"It came to a point where he was going to sell," Rachel said. "It was obvious we would be the natural buyer if we could put that transaction together."

The dynamics of that negotiation were simultaneously "wonderful and terrible," Rachel said, given that the seller was chair of North Star and signed his paychecks.

"Who can sell your bank for a 100 percent cash transaction and still own part of it without buying stock?" Rachel asked the audience. "I would guess that's probably almost nobody. Because this partnership was put together, one of the benefits is that it can create a market for your own organization. We bought his bank, paid him fair market value in cash. And he still owns a large percentage of it through us because he was an owner of Unison. Now, that is the uniqueness of an idea."

Taking advantage of the other benefits of the ownership structure, such as sharing loan participations across all four holding companies and sharing operational expenses, has allowed Unison Bank to grow to $580 million and three offices in North Dakota, and also given it the ability to expand to Arizona, where 55 percent of its loan portfolio originates, the majority of it funded by North Dakota deposits.

Having three separate holding companies as buyers brought a few surprises; not insignificant was the need to file four applications, along with the need to create a top tier holding company between the three ownership holding companies and the bank, Coleman explained.

"One of the issues that the three holding companies had to deal with was the Fed's Source of Strength Doctrine," Coleman said. While each HC did not represent majority ownership (all were less than 50 percent), "they were responsible for a source of strength for the entirety of the bank."

"North Star Holding Company is there in the middle in part to create some distance," Coleman said. "But also to allow for them to work together to try to satisfy the Source of Strength Doctrine, rather than each one borrowing money or going out to raise equity individually. In theory, they could do so through North Star Holding Company and downstream it all to the bank."

In the early years after the deal was struck, boardroom dynamics needed improvement. The three BHC owners represented family banks, closely held banks, Rachel explained. "It can be interesting in any closely-held company, banking or otherwise, with family dynamics. We're the larger organization. We have a management team in place and we're running efficiently. My management team doesn't care about the family dynamics of our owner's banks. That's your bank, your organization, and that stuff can stay at home," said Rachel, who has been president and CEO since 2012, and is not a family member in ownership.

More than 20 years along, board dynamics have emerged, Rachel said. "Our board is very different from most because everybody on our board is a career banker. The North Star board provides one seat for each ownership group, and two from North Star. "My priority is Unison Bank, our expectations, our goals. I never get, 'That's not how we do it back home.' Now it's much more collaborative with them asking 'How do you do it here? How can I take that back home to my ops team? How do we synergize together? How do we clone each other's products better?'"

Lindholm, who has amassed bank holdings in two states worth roughly $850 million across his 47-year career, discussed timing of his acquisitions, along with the coordination of operations and branding with attention to maintaining a consistency of experience for the customer.

Lindholm began his acquisitions in the 1990s focusing on small rural banks in western Minnesota. "There were some challenges, some special problems or issues we had to fix … some stress involved," Lindholm said. "Of course, I like that challenge. We liked being in these rural communities and we were able to make them work pretty well after a period of time. Later on we changed our strategy, strategically. I felt we should acquire high performing banks that had management in place."

As his acquisitions stacked up, Lindholm took his time merging charters. Choosing when to merge when it was most cost effective allowed the company to consolidate job functions and avoid termination fees on data processing contracts. "We had one operation manager for all the banks, even though we were separate charters," Lindholm said.

When his banks did change names to remove geographic reference points, Lindholm said some customers need time to

Kelly Rachel, president and CEO of Unison Bank, described how ownership of the Jamestown, N.D., institution evolved during the last two decades.

adjust. "If the experience is the same when [customers] come into the bank, they're seeing the same people, they're experiencing the same approach to loan approvals, I think it works fine," he said.

The problem facing banks that serve rural communities is finding a way to grow as populations stagnate or decline. When the opportunity to buy in South Dakota appeared, Lindholm said it was imperative that there was solid management in place. You can't just upend top performers who are embedded in their communities and move them to another state, he said.

While Lindholm has now collapsed all of his Minnesota bank charters into one, he maintains a separate charter in South Dakota.

Assessing Lindholm's business, Coleman said it was easier for FM Bank to grow by acquisition than organically given the realities of rural America. "If you are a bank or bank holding company in a rural area and you're struggling with the opportunity to find organic growth, maybe look for acquisition opportunities, maybe you look to push out the geography a little bit," he advised. ■

Down to Business, *Continued from page 5*

largely made based on the strength of each candidate's statement of interest. Both Scott and Sean wrote thoughtful letters to the board expressing their respect for the BHCA and their interest in serving on its board.

During the early morning meeting on Oct. 8, the membership also elected three holding company members to three-year terms on the board of directors. Those elected were: Vicki Turnquist of Bakken Securities in St. Louis Park, Minn., Jeff Restad of State Bankshares, Inc., in Fargo, N.D., and Steve Burgess of NATCOM Bancshares, Inc., in Superior, Wis. Terms for all five of the newly elected board members will begin on January 1, 2025.

Rolling off the board at the conclusion of 2024 are Stephen Goodenow of Goodenow Bancorporation of Okoboji, Iowa and Denise Bunbury of State Bankshares, Inc, Fargo, N.D. A third seat was vacated upon the death of Harry Wahlquist of MidWest Bancorporation, Eden Prairie, Minn., who was in the final year of his second term on the board.

It is my honor to thank each of the board members who are completing their service, and to congratulate the members who are joining the board. We have a strong association and a big part of our success relates to our engaged volunteers. Thank you very much. Best wishes, Merry Christmas and Happy New Year! ■

Experts offer advice, insight on the current M&A landscape

By Mara Gawarecki

Aging leadership and a lack of talent can push a bank toward selling, a panel of lawyers and accountants agreed at the Fall Seminar of the Bank Holding Company Association. Plus, they said, the rise of nontraditional buyers in a slow M&A environment has added complexity.

Paul Ouweneel, an accountant with Wipfli, said he'd seen one deal during the previous decade with a selling institution under $2 billion in assets that wasn't driven by an aging board, aging C-suite or aging ownership. "If you want to remain independent, the first thing that needs to be addressed is the talent question," he said. "We are at a place where we have these generational demographic shifts and a lot of uncertainty just in what the next one to three to five years is going to look like."

"If you're looking to acquire, we fully expect that there's going to be quite a bit of opportunity here in the next 12 to 24 months," added David Heneke, a CPA with CLA.

Deal volume remains below historic norms, Ouweneel noted, and a quarter of the deals he's seen this year featured non-traditional acquirers, including credit unions, mortgage companies and others.

Acquirers are seeking talent and profitability from scale, Heneke said, although he dismissed the notion that scale is necessary to run a bank well. "Some of the most profitable banks are sub-$500 million," he said, although he acknowledged that bigger banks have a larger margin for error.

One of the largest areas of cost growth has been technology, said Jim Reichert of Reinhart Boerner Van Deuren, with expenses for both defense and offense rising notably in recent years.

From left to right: Tony Moch, Winthrop & Weinstine; Paul Ouweneel, Wipfli; David Heneke, CLA, and Jim Reichert, Reinhart Boerner Van Deuren.

David Heneke, CLA, expects opportunities for bank buyers to increase in 2025.

"Scale will help, but talent will also go a long way to solve that," Ouweneel added.

When comparing traditional bank buyers to more recent, non-traditional, non-bank buyers like credit unions or finance companies, Ouweneel outlined general considerations for potential sellers. "[Banks] are a known quantity, but their pricing in general is below that of the non-traditional buyers," he said. "The non-traditionals, for a variety of reasons, are able and/or willing to pay higher multiples — in some cases, much higher multiples. But what they represent is execution risk in deal speed and certainty to close."

In the current uncertain economic climate, more banks are opting for stock buybacks or tender offers. "People are saying, 'I'd rather buy me than somebody else because I know our balance sheet and I know our risk and I can get us for cheaper than that bank across town,'" Reichert summarized.

Recent regulatory changes, especially at the FDIC, have helped contribute to the slowdown in M&A activity, said Tony Moch of Winthrop & Weinstine. Deals with non-traditional buyers, which face heightened regulatory scrutiny, can expect even more time in review, the panel agreed.

When non-bank, non-CU buyers approach a deal, they might not care about geographic location, Reichert said. "They want to make sure that you have a management team that can keep running the bank because that's not why they're buying the bank," he said. "They want to bolt other things onto it." These buyers might have started a *de novo* charter in the past, but in the current environment, it's easier to buy a charter than start from scratch.

Expert Advice, *Continued on page 11*

The changing rate environment holds risk and reward

By Mara Gawarecki

"Today is the single most attractive environment for buyers and sellers that we've ever seen," Gary Svec, managing director of Performance Trust Capital Partners, told attendees at the Bank Holding Company Association Fall Seminar.

Cost of funds will continue to rise in a rates-down-moderately or rates-unchanged environment, Svec said, but rates-up would be a disaster for the industry.

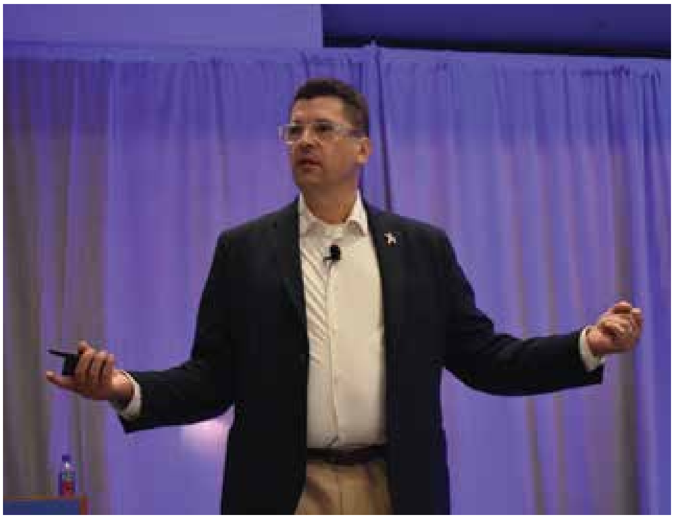
"We do not as an industry have a funding problem," Svec said. "We have a massive funding advantage, but that also creates a risk." As depositors realize they can get higher rates elsewhere, they're more likely to move their money. "Your deposit portfolios are far more valuable today than they ever were in 2021."

The key problem doesn't lie with cost funds but rather asset yields, Svec said, and that's where bankers should look for solutions.

The current M&A decision-making framework is accurate but incomplete, Svec said. Bankers should be running multi-interest rate scenarios on both their own budgets and any potential acquisitions they're considering.

"If I'm not running multiple interest rate scenarios in my own budget for my own institution in the most volatile, uncertain time in our careers," he said, "how can I say I only need to look at one in the largest capital allocation decision in my career?"

Using multiple different rate scenarios lets bankers identify where risks and rewards are, which should impact the structure of the definitive agreement. "This influences the things that I'm worried about between now and closing," Svec said. "If I don't know where my risks are in a deal, how the heck am I supposed to write a definitive agreement?"



Gary Svec of Performance Trust encouraged bankers to run a variety of interest rate scenarios.

Bankers must know their own institution before they consider any deals, Svec noted. "The only way I know how to negotiate is to know the numbers before I walk into the room," Svec said. "Otherwise it's kind of like playing blackjack without ever looking at your cards." ■

Expert Advice, *Continued from page 10*

For sellers considering non-traditional buyers, it is crucial to screen them properly, Moch said. "If they have a lot of money, but they haven't talked to legal counsel or to experienced financial advisors, they have no idea what they're talking about," he said. "It doesn't matter what they're offering, whether it be price to book, price to earnings — if they can't get the deal done, that is a very unsettling, uncomfortable place for the seller to be in."

Such sellers should consider adding a breakup fee in the "significant six figures" for non-regulatory approval to make sure nontraditional buyers have sufficient skin in the game, Ouweneel added. Contracts can also include negotiable drop-dead dates, in which nontraditional buyers who need additional time to receive regulatory approval can extend the deadline for a fee, Reichert suggested.

Deposit due diligence is increasingly a concern, even at small community banks with a high percentage of sticky core deposits from shareholders and directors, Reichert said. "For the first time, we're looking at deposit diligence and our clients are pushing us and pushing the sellers to explain, 'Are these good deposits? Are they gonna stay if we pay out?'" he said. "Are the deposits gonna stick around or are they heading to Florida?"

"The definition of what a core deposit is is probably changing right before our eyes in regards to customer behavior," Heneke said, highlighting the importance of considering the age of deposit customers. "The question became in due diligence, 'Well, do you have a relationship with the kids?' And pretty much in all situations they did not."

Overall, successful acquirers know their institutions and their criteria, and are proactive in their search, Moch said. "They're constantly having discussions even with competitors that are not necessarily for sale," he said. "They're having those ongoing conversations on a regular basis because for every 10 conversations you have, you get one nibble." ■

Economist: Recession possible amid mixed economic signals

By Sam Wilmes

There are signs of a looming recession even as economic numbers remain strong, economist Elliot Eisenberg said Oct. 8 during the Bank Holding Company Association Fall Seminar in Edina, Minn.

Eisenberg was apprehensive over the recent rise in unemployment to more than 4 percent without an increase in firings. Unemployment remained little changed in September at 4.1 percent, according to the Bureau of Labor Statistics. He was also concerned by a jump in credit card delinquencies, especially for 20- to 40-year-old customers. The 30-day delinquency rate for outstanding credit card balances increased in the second quarter of the year to 3.25 percent — its highest mark since 2011 — from 3.15 percent in the first quarter.

Even if a recession occurs, the impact to government and health care sectors is usually limited, Eisenberg said. More affluent Americans are doing better while lower wage earners are struggling to get by, he noted. The savings rate is less than 3 percent, which Eisenberg deemed "troublingly low."

Despite softening economic conditions and tight government fiscal policy, Eisenberg cited the uninterrupted growth in consumer spending along with corporate investments in plants and inventories as positive signs. Companies are still building plants to produce batteries and chips.

Describing the state of the mortgage market, Eisenberg said the pace of home price appreciation has slowed as home sales are soft.

Economist Elliot Eisenberg noted the strength of the economy but said a recession remains possible.

Single-family home starts are strong while multifamily starts are weaker.

Eisenberg attributed the Federal Reserve's role in the relatively healthy economy to luck. He claimed the Fed is behind the curve. Ten of the last 13 times the Fed raised interest rates resulted in a recession, Eisenberg noted: "The Fed has no idea where they are going, zero."

Eisenberg, who cited the steep drop in banks nationwide to approximately 4,400 this year from 18,000 in 1985, said it makes sense for banks to sell to maximize earnings during the current cost environment. ■

Tax considerations in the current environment

By Mara Gawarecki

Many of the tax cuts set to sunset at the end of 2025 are unlikely to be renewed should Vice President Kamala Harris win in November's election, said Kara Cramer, a tax partner at the accounting firm of Forvis Mazars. Conversely, Donald Trump has promised to make the cuts enacted under the 2017 Tax Cuts and Jobs Act (TCJA) permanent.

Trump has promised to lower the corporate tax rate to 20 percent from 21 percent and even floated the possibility of a 15 percent rate. Harris has proposed raising that rate to 28 percent as well as increasing the corporate alternative minimum tax rate to 21 percent from 15 percent.

Generally, where Trump has proposed making cuts permanent, lowering rates or increasing exemptions, Harris has proposed a corresponding, opposite increase or reduction, Cramer summarized. For example, on Section 199A, the pass-through deduction of 20 percent on qualified business income would become permanent under Trump while it would only extend to those earning less than $400,000 under Harris.

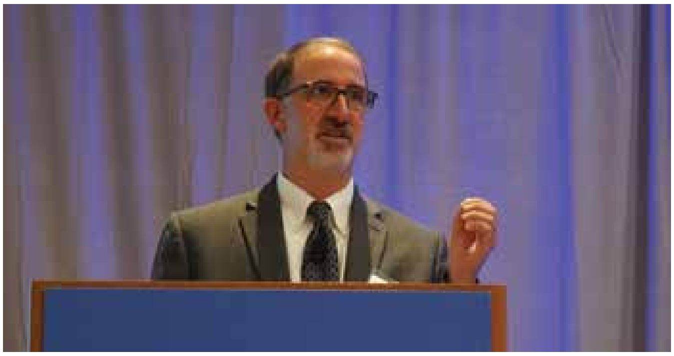
Kara Cramer of Forvis Mazars said President Trump would make TCJA tax cuts permanent.

When it comes to Congress, a Democrat sweep would likely mean increased child tax credits and a focus on small businesses and affordable housing, Cramer said. They would likely extend

Tax Considerations, *Continued on next page*

Experts: Surge in M&A inevitable, timeline unknown

By Sam Wilmes



David Stieber, TruStar Advisors, encouraged bank owners to establish an ongoing stock buy back program.

A surge in mergers and acquisitions is likely, but the timeline is unknown, said TruStar Advisors Co-Founder Craig Mueller.

Speaking with fellow TruStar Co-Founder David Stieber Oct. 7 during the Bank Holding Company Association Fall Seminar, Mueller said a lack of succession planning remains the No. 1 reason for bank owners to sell.

Mueller estimated 3-to-5 percent of banks deemed in "outstanding" condition are being consolidated on an annual basis. Both the overall number of credit union-bank acquisitions and assets involved in such deals have set records this year. The number of bank M&A deals during the past five years — 750 — has lagged below the historical five-year average of 1,250, Mueller said. Seventy-five percent of bank M&As during the past five years have involved banks with less than $500 million in assets, he added.

Mueller effectively mixed his knowledge of the M&A arena with personal insights and humorous anecdotes. "There is an M&A flood that's going to come," he said. "We don't know when it's going to trigger. I said next year, David said this year. He's already wrong, so again, older and wiser I'm questioning whether or not it's going to be next year, but there is a lot of pent-up demand out there."

The needs of private bank shareholders who desire "complete liquidity" include selling the bank or going public, Mueller said. Banks where a subgroup of shareholders want complete liquidity have several options: instituting a buyback program; repurchasing a large portion of stock at once; privately negotiating a large shareholder sale; and exchanging stock for debt.

Mueller called on bank owners to have their banks in order and be selective in their M&A targets to account for the often lengthy regulatory approval process. Stieber encouraged bank owners to have an ongoing stock buyback program, possibly through pledging up-front to buy back 5 percent of its stock, or annually giving stockholders the option to acquire 5 percent of the bank's stock.

A good way for banks to remain independent is buying back 10 percent of its own stock, Stieber added. Banks with an aging shareholder base can diversify their base of stockholders by attracting new investors. "If you do a buyback, maybe a tender, you can replace 20 percent of your shareholder group with younger shareholders who are like-minded who want to support your community bank and support the community," he said.

Mueller and Stieber also discussed current economic conditions. The yield curve remained inverted as of early October, which has historically been a reliable indicator of a recession. Most banks are under significant earnings pressure with historically low margins and limited organic growth opportunities, Mueller said. Community banks are seeing higher-than-normal investment securities losses from retaining Paycheck Protection Program deposits and ongoing high interest rates.

The median return on average assets for banks with $1 billion to $3 billion in assets increased to 0.83 percent in the second quarter from 0.77 percent. Median ROAA increased to 0.78 percent from 0.71 percent for banks with less than $1 billion in assets. The median price to tangible book value for all publicly traded banks is 122 percent, compared with 101 percent for publicly-traded community banks. ■

Craig Mueller, TruStar Advisors, said a flood of M&A transactions is coming.

Tax Considerations, *Continued from previous page*

TCJA tax cuts for those making less than $400,000 annually while allowing them to expire for those with higher incomes. Republicans would likely hold child tax credits at current levels, TCJA levels and prioritize R&D expense capitalization, 100 percent bonus depreciation, and a 163(j) business interest limitation change.

Cramer also covered the differences between an asset and a stock transaction, the deductibility and capitalization of costs that are involved with a transaction, and accounting for income tax considerations that are needed during a transaction. ■

As fraud incidences rise, so should banker vigilance

By Jackie Hilgert

Protecting a bank from the ubiquitous data breach involves training, the right levels of insurance coverage, and a close attention to vendor contracts. That was the message delivered by Kris St. Martin, vice president and Bank Program Director of CBIZ, and Carolyn Purwin Ryan, a partner in the law firm Mullen Coughlin, during an Oct. 8 breakout session at the BHCA Fall Seminar.

Trying to mesh customer convenience with security is increasingly difficult. Artificial intelligence, deep fakes, and social engineering fraud have grown sophisticated. At the root of social engineering fraud is a takeover and subsequent monitoring of an email account.

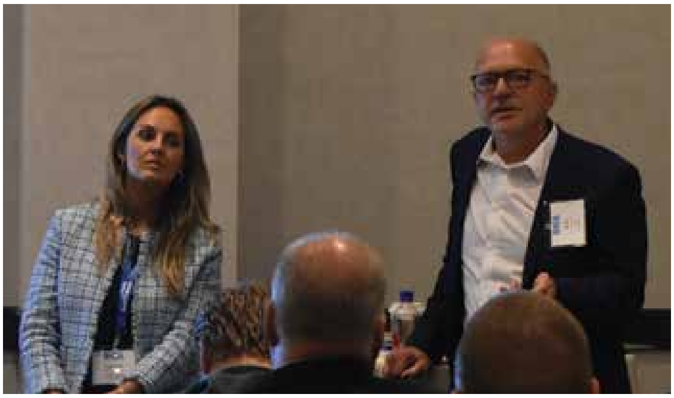
St. Martin laid out the details of a social engineering fraud he worked through that led to wire fraud. The issue stemmed from the sale of a farm worth approximately $8 million. The owners were represented by a realtor whose email had been compromised. As a result, fraudsters knew all of the details of the closing and sent false wiring instructions. Fortunately, the fraud was detected before the money vanished from the bank that received the wired funds. “Even if this was not the bank’s legal liability,” St. Martin explained, “the pain and the amount of time that the bank would have to deal with this, what customers would be going through, would just be immense.”

St. Martin said banks are upping their training for staff and for customers. “They’re doing seminars; they’re doing webinars; they are talking to their customers about all these kinds of fraud,” he said. “The more I think you educate your customers on all of this, it’s going to create goodwill to your customer, reduce their potential liability.”

St. Martin said he frequently works with groups of bankers to deconstruct attacks to help train teams how to spot attacks, and how to respond. “I’m a big proponent in educating your customers in any fashion possible,” St. Martin said. “It helps create goodwill. It helps them stay out of trouble. And, it’s a little bit harder to sue somebody who you think has been a good advocate.”

Also wise is reviewing bank policies for wire transfers with customers. “Banks must be able to defend their wire transfer process,” St. Martin said. “I think that’s good practice anyway.”

It’s also important to review insurance coverages with an agent/carrier. “A lot of people assume [wire fraud] is part of your cyber policy,” St. Martin said. “It’s not; it’s part of your crime bond policy because it’s theft of money. That’s where you’ve got to look at the different scenarios and make sure you have the right coverage of the bond itself.”



Carolyn Purwin Ryan of the Mullen Coughlin law firm, and Kris St. Martin, CBIZ

Some of the greatest headline generating breaches of 2024 occurred outside of banking, but could well have impacted banks. This opened the door to discussing how vendor relationships create vulnerabilities, especially when a vendor has access to a bank’s data (think core provider).

Before something like this occurs, Purwin Ryan said, find out what the vendors’ obligations to the bank are. They might limit their obligation to simply notifying banks which customers are affected, placing the onus to notify on the bank, she said, encouraging bankers to look at vendor contracts before a breach occurs to see where the limitations exist. Most contracts, she said, are written to benefit the software companies. “It is important to take a look at those contracts to determine who is the data owner … because that ultimately decides who is going to be going through the notification process.” She also suggested a timeframe for notifications be laid out in the contract.

Be wary also of language that limits vendor liability to what you are contracted to pay them for a certain term. If you are contracted to pay $50,000 in one year for their service for example, St. Martin said, the ceiling for their liability might well be $50,000. “In a lot of these fraud cases, that isn’t nearly enough,” he said, especially if the bank is later sued as a result of the breach.

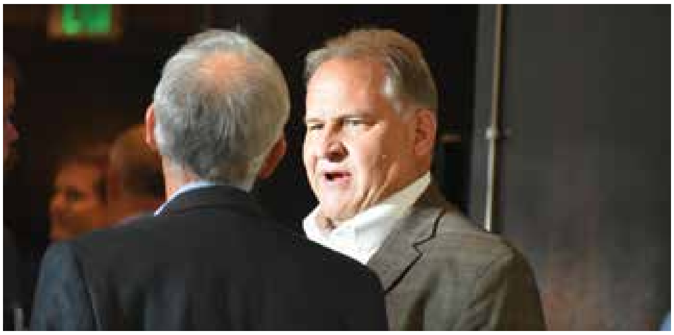
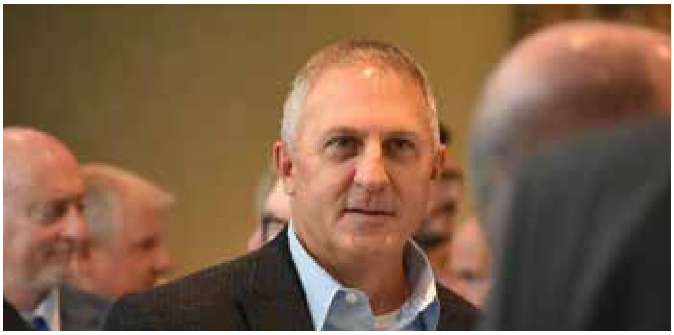
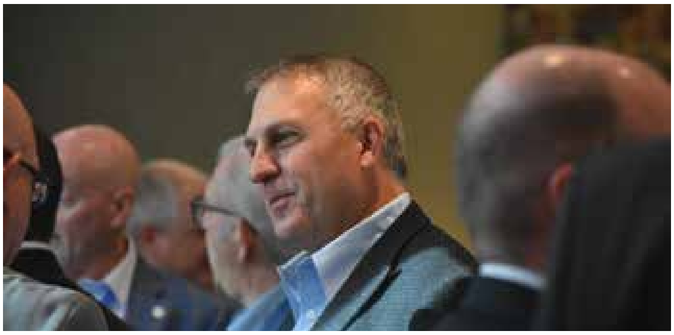
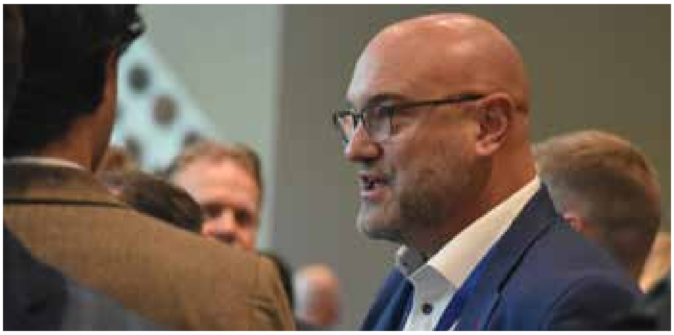
Compared to other business sectors, banking has led in the prevention of cyber fraud, St. Martin said. Yet technology is allowing bad actors to continue to gain an edge. And it’s working. A study conducted by the Federal Reserve Bank of Boston indicates that check fraud in 2023 was $20 billion, up from $100 million in 2006.

The imperative, therefore, is to stay vigilant, urged St. Martin: “Question the experts within your bank and ask good questions, like: “How do we handle these types of things?” ■

Scenes from the 2024 Fall Seminar



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