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Despite the relative dearth of financial institution M&A activity in the current market of uncertainty, boards always need to be prepared for taking advantage of strategic opportunities. Whether as buyer or seller, or to simply remaining status quo and independent, boards need to have an "M&A strategy" in place. This preparation needs to take place **before** a situation arises in order to enable the board to exercise appropriate control of the process so that they are able to exercise their obligation to act in the best interests of the institution and their constituency without having to react with the proverbial "gun to the head."

Preparation is critical. A last minute scramble under the pressure of an unforeseen acquisition opportunity to act as a buyer, the unanticipated receipt of a "bear hug" from an interested acquirer, receipt of an unsolicited offer, or other unexpected opportunity takes away board options and alternatives that the institution may otherwise have when the board has a unified and cogent strategy and has implemented appropriate measures to provide for their ability to exercise control over the situation. Not necessarily to thwart otherwise appropriate opportunities, but rather in order to enable the directors to exercise their best business judgment and act in the best interests of their constituencies.

While the classic "hostile" approach is fortunately rare in banking, the interests of shareholders and shareholder groups may vary and situations can and do arise where boards are placed in difficult positions of having to address divergent and conflicting interests. Hedge fund, private equity and activist investors are becoming more prevalent in the community banking space too, and may enter as a "Trojan horse" investor whose intentions appear altruistic at first.

In the current environment of economic uncertainty, inflation, market volatility, and changing interest rates, the likelihood of increased regulatory pressures, shareholder activism, and M&A activity is very real and will be ever-increasing factors to consider seriously in the planning

process.

A number of mechanisms are available to prepare the organization to address potential buy-side M&A activities if and when they arise, as well as the possibility of unexpected acquisition opportunities or undesired or surprise approaches by potential acquirers. Boards should be able to demonstrate that they have reviewed and considered these various mechanisms and have developed plans to deal with these activities in advance of finding themselves in an awkward position. Mechanisms adopted and implemented by the board should provide maximum flexibility for the board to carry out their strategic vision while at the same time allowing for potential unforeseen changes in the market and in their individual situations. While an institution may be poised to be a buyer, an unforeseen and desirable opportunity to sell may arise and the board needs maximum flexibility to be able to respond to that in a manner that provides for it to exercise its' fiduciary obligations. Likewise while an institution may have a strategic plan to be a seller, unforeseen opportunities may arise for acquisitions which may be in the best long-term interests of the institution and its constituencies. Therefore maximizing board flexibility to react to situations as they arise, and to better control the destiny of the institution in the best interests of its constituencies, is critical to provide the board with appropriate options and alternatives.

The purpose of preparation is not to inappropriately thwart potential acquirers who may have an interest in the organization, or to entrench the board and management, but rather to provide appropriate tools for the board so as to maximize its' ability to deal with such situations in the best interests of the institution and its constituencies. Attention to the existing shareholder base, understanding the makeup and interests of the shareholders, good shareholder relations and a strong stock price are some of the most important defenses to an unwanted approach by an acquirer, but boards also need the appropriate actual structural and legal tools to do the job if the situation in fact arises. These situations can and do sometimes escalate quickly and totally unexpectedly, simply as the result of a curious inquiry, "lunch" with a potential partner or investment banker, or because of an unknown concern of a major shareholder or disgruntled family member. Institutions can inadvertently be "put in play" without ever intending to be placed in that position. "Bear hug" letters from interested acquirers are not unheard of in the banking industry, and a cohesive and informed board is critical to address unexpected and possibly unwanted overtures.

Preparation is critical, and a last minute scramble may place the institution and its board in the worst possible footing to deal appropriately with situations that may arise.

Governance Preparation

For starters, a comprehensive review of the governance mechanisms in place and already adopted for the institution, and their adequacy and appropriateness, is important to establish a baseline. Doing this well in advance of a situation arising is critical in order to allow the board to exercise their fiduciary obligations and to control the process in the best interests of the institution. Having the discussion for the first time when facing a potential transaction provides fodder for shareholder issues and for losing control of the situation.

Director education and updates with regard to takeover preparedness, coupled with development of an appropriate long-term strategy, helps to avoid last minute scrambles and helps keep the board informed, involved, and better able to address issues as they arise.

Appropriate and up-to-date structural provisions are also critical in order to provide the best tools for the board. Governance document provisions contained in articles, bylaws, constitutions and codes of regulations such as staggered boards, the availability of "wild card" stock, prior notice for shareholder actions, having a "white knight" or "white squire" in place, "supermajority" vote requirements, "fair price" provisions, rights plans and director eligibility are critical, as well as appropriate benefit programs and appropriate change in control protections provide tools for the board to deal with unwanted overtures. Likewise as noted below, for potential acquirers the ability to raise equity, issue debt, or borrow may be important for flexibility in taking advantage of potential acquisition opportunities.

Timing of adoption of these changes is critical and is typically not best when the institution is already in play, voluntarily or otherwise. Hence the importance of reviewing these issues and making any changes that may be appropriate for the institution in light of its strategic plans BEFORE it is facing the issues as opposed to a scramble in the heat and pressure of battle.

Shareholder Meetings

Even the conduct of shareholder meetings is important so as to provide appropriate shareholder accessibility but not to open the door to abuse by those who would seek self-serving action that the board, in exercising its legal duties and responsibilities, deems inappropriate. Annual shareholder meetings are not typically the best venue for in depth review and discussion of important governance matters or director nominees that really require significant analysis and in-depth review and assessment of the best interests of the institution.

Acquiring Institutions

Like potential targets, potential buyers need to plan so as to be able to move quickly on opportunities that may arise, especially knowing that they may be facing competitive bidders which these days include credit unions. From access to cash for acquisitions to available shares for issuance, potential buyers likewise need to make certain that they are strategically positioned to take advantage and to be nimble when opportunities are presented, and in that regard to maximize their options for responding. A board with growth as a strategic goal needs to review not only its governance and materials for the ability to, for instance, issue shares and raise capital quickly if appropriate, but to make certain that the board has sufficient latitude to move quickly on any number of matters when necessary. Advance planning, knowing and understanding potential targets and target markets, and (***importantly***) having conversations in advance with appropriate regulatory authorities, can enable the board to be nimble and efficient when addressing potential growth opportunities and to stay in front when there may be multiple interested parties. Unanticipated regulatory roadblocks to potential acquisitions can be embarrassing when discovered late in the process.

Indemnification and D&O Insurance

As part of an overall review of governance protections, boards should continually review the adequacy and appropriateness of indemnification provisions in governance documents as well as the appropriate level and coverage provided by D&O insurance. Transactions historically provide the most significant opportunities for second-guessing by plaintiff's lawyers (a fact of life in almost every announced

transaction these days), shareholders and sometimes regulators. The board should continually review the protections in place to make certain that they are appropriate for their needs and for their strategic vision. Whether as buyer or seller, the M&A world can be fraught with potential liability issues for directors, and proper use of financial and legal advisors can provide important protections in the process.

Conclusions

With appropriate preparation, potential target boards have significant latitude in dealing with unwanted advances, from "just say no" to taking the offensive, but that latitude is tempered by the need to always act in the best interests of the institution and to be prepared to defend the position taken. To do that, boards need to formulate a strategic plan in advance, and one that is continually carefully reviewed and updated as appropriate. Boards also need to ascertain that they have in place the appropriate tools to deal with unforeseen issues as they arise in order to fulfill their obligations to the institution and its relevant constituencies.

Likewise, potential acquirer boards should have significant latitude to plan to be ready to move quickly and efficiently when opportunities arise and, if done correctly, to develop relationships with potential strategic partners and undertake approaches that avoid placing the potential partner in an awkward and unwanted position with their shareholders and/or regulatory authorities. Potential acquirers are wise to keep in mind that, in most instances, the structure of an acquisition results in the acquirer taking on the known and unknown financial and other obligations of the selling institution as well as potential shareholder and other "baggage" of the seller, so a good approach and good relationship will pay long-term dividends for the combined organization. Hostile acquisitions, including those that are not openly "hostile" but are in fact perceived as such by the employees, shareholders, community, and selling institution because of the manner of actions by the buyer, are seldom successful financially or otherwise.

Whether as a prospective acquirer or target, waiting until a situation is unexpectedy thrust upon the board is not the time to be planning and implementing the types of opportunities and protections for the institution that are necessary and appropriate to enable the board to fulfill its obligations.