ALABAMA BANKERS ASSOCIATION

BOARDBRIEFS

A NEWSLETTER FOR ALABAMA'S BANK DIRECTORS

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IN THIS ISSUE

Directors' Responsibilities: A Brief Refresher

By Jefferson K. B. Stancill

What does it mean to be a director of a bank? The ultimate corporate authority rests with the board so a board's fundamental job is to direct the business and affairs of the bank. In other words, the buck stops in the boardroom. Of course, experienced directors know the job may be easier said than done. Directors are routinely faced with difficult decisions requiring them to weigh the diverging interests of shareholders, customers, employees, and communities. While there is no formula for every board decision, the law provides a guide that is based in two general obligations: the duties of care and loyalty.

According to the duty of care, you must serve your bank with proper judgment, discretion, and diligence, and you should devote appropriate attention and care to your decision-making. The FDIC offers this simple guidance, "Act as prudent and diligent business persons in conducting the affairs of the bank." Regular meeting attendance is an important part of the duty of care, but your obligations don't stop there.

- **Know your limitations and seek advice.** You are not expected to be an expert on every topic, but you are expected to exercise prudent judgment in every circumstance. To exercise your best business judgment on a topic that is not familiar to you, you may need to do some homework or seek advice from an expert. Have the humility to acknowledge when you need help from management, other directors, or outside advisors like accountants, consultants, and lawyers.

- **Listen.** Require management to give regular and substantive reports, and listen carefully. If a topic is raised to the board, it deserves your attention.

- **Encourage and participate in board discussion.** The law requires bank directors to meet regularly, and a central purpose of those meetings is to provide a forum for important discussion in real time. Each director brings a different and valuable perspective. Of course, some board actions may not require much discussion, but meaningful board action should generate meaningful discussion. Encourage that discussion, listen to the other directors, and voice your thoughts and questions.

- **Ask questions, even the hard ones.** Ask questions to get to the information you need to equip yourself to make informed, educated judgments. Occasionally, you may need to ask difficult questions about the bank's performance, personnel matters, or other things. Your job obligates you to

ask these questions, so don't be afraid to challenge management and other directors.

- **Stay up to date and be proactive.** Staying ahead will allow you to address small issues before they become big ones. This may include reading industry publications to stay up to date and participating in substantive training. For example, a prudent director might study the recent increase in bank consolidation to consider whether your bank should explore buying another bank or selling itself, and a prudent director may educate himself on community trends to determine potential directions for the bank.

The duty of loyalty generally requires a director to put the bank's interest before individual interest, using good faith, candor, personal honesty, and integrity. You may not advance your own interests (or the interests of others) at the bank's expense.

- **Do the right thing.** Directors are entrusted with an important task, and you must undertake your job with integrity. In every decision, consider what is right for the bank above your own interests.

- **Be cautious about conflicts of interest.** Boards of directors often include local business people, and local business people often do business with the bank. If you have an interest in a transaction that diverges from the bank's, you should be very careful. You should disclose any conflict of interest to the board immediately, and it may be appropriate for you to allow the remaining directors to handle the transaction without you. Examples of transactions that could trigger conflicts of interest include circumstances like: a director owns a building that would lease space to the bank or a director's spouse is a partner in an accounting firm the bank proposes to engage.

Special circumstances occasionally arise that require particular attention.

- **Enhanced regulatory scrutiny.** If your bank becomes troubled or becomes subject to regulatory action, your regulators will expect the board to take an enhanced role in the bank.

- **Significant transactions.** If your bank is considering an expansion, a merger, a sale of stock, or other significant transaction, the board should be very involved and should consider engaging legal counsel and financial advisors early in the process.

- **Director stock transactions.** A director holds a fiduciary position and has access to information about the bank that is not publicly available. So, directors should exercise caution in buying and selling stock. Inappropriate transactions can subject a director to liability and even criminal prosecution.

- **Zone of insolvency.** If your bank's financial condition deteriorates, directors may need to order the affairs of the bank to ensure creditors are paid before shareholders. This is called the "zone of insolvency," and some courts have applied the concept more broadly than you might expect.

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Real Estate Due Diligence: Satisfying Professional Standards and Report Requirements

By John Pickering

Most lenders are familiar with the standard due diligence required to close a commercial real estate loan. A standard due diligence package would include an appraisal, a survey, a title insurance commitment, a Phase I environmental site assessment, insurance certificates, a flood insurance determination, and copies of any tenant leases, among other things. But some lenders overlook the "due diligence on the due diligence" – that is, the work required to verify that the professionals who are providing some of these items are properly qualified to do so and that the reports conform to the proper industry or regulatory standards. Neglect of this verification can mean that the report upon which the lender is relying is not sufficient to uncover the types of issues it is intended to uncover.

For example, under the federal Interagency Appraisal and Evaluation Guidelines, which set detailed appraisal standards for real estate lending, an appraisal can only be provided by someone who "holds the appropriate state certification or license at the time of the assignment." The appraisal itself must "conform to generally accepted appraisal standards as evidenced by the [Uniform Standards of Professional Appraisal Practice] promulgated by the Appraisal Standards Board of the Appraisal Foundation unless principles of safe and sound banking require compliance with stricter standards." Most banks now have established procedures for obtaining and reviewing appraisals which were established after regulatory pressures increased following real estate market crashes in the now-distant past.

Regarding the standards for other real estate due diligence items, banks have somewhat more flexibility in establishing their standards and procedures.

For Phase I environmental reports, the relevant industry standard is ASTM E1527-13, which was revised in 2013 to require consideration of vapor impacts and to require either a regulatory file review or an explanation regarding its omission. ASTM E1527-13 contains extensive requirements for what must be included in a Phase I and specifies that the Phase I must be conducted by an "environmental professional" who meets specific degree and years-of-full-time-relevant experience requirements. Even though ASTM-E1527-13 sets forth the standards for a Phase I, there is no specific regulatory requirement for a bank to obtain a Phase I when making a real estate loan other than the general requirement to protect the safety and soundness of the bank and the possible protections for the borrower and the bank to be gained under the federal superfund legislation by obtaining a Phase I before a property is purchased. Hence, banks often dispense with the Phase I requirement and employ a less expensive "environmental review" for smaller loans where the property is not an obvious high risk for environmental issues. Likewise, no specific property insurance requirements are mandated by laws or regulations for real estate collateral; however, many lenders will require that the insurance be issued by a company with certain minimum ratings that is licensed in the state where the property is located.

The industry standards applicable to a survey illustrate one of the hazards of relying on old procedures – the fact that most standards are periodically updated. First adopted in 1962, the survey standard required by most lenders and developers is the "Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys," jointly established and

adopted by the American Land Title Association ("ALTA") and the American Congress on Surveying and Mapping (since merged with the National Society of Professional Surveyors ("NSPS")). A compliant survey is often referred to as an "ALTA survey." But the ALTA survey standard has been revised effective Feb. 23 when the next edition of the Minimum Standard Detail Requirements for ALTA/NSPS Land Title Surveys takes effect. The new standard involves quite a few revisions, most of which are minor, but some of the more significant revisions include better guidance on how to locate and depict abutting streets and roads, making utility features a mandatory survey item, requiring explanations for new or revised legal descriptions prepared by the surveyor, requiring a zoning letter from municipal officials as a precondition to having the survey address zoning, and remove a wetlands reference from certain optional survey items because of the confusion it creates in the marketplace. Of course, as with the Phase I report, there is no specific regulatory requirement that all commercial real estate loans be backed by an ALTA survey. Indeed, many banks do not require the more-expensive ALTA survey on smaller commercial loans, accepting a "minimum state requirements" survey instead, which generally means that the surveyor has the appropriate state license for providing survey services.

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Is IT Management a New Target for Bank Regulators?

By Terry Ammons

My firm has been working with community banks for years. In the last 12 to 18 months, we've been seeing a new trend: the increased scrutiny by regulators on the IT function and IT management. In several cases, that scrutiny has resulted in rating downgrades and even regulatory actions, such as formal board resolutions or Memorandums of Understanding.

The banks were generally surprised to be on the receiving end of this scrutiny. There were conversations that went something like, "Well, they are writing us up for stuff that has been in place for a while," or, "The same comments that were a slap on the hand previously have really got the regulators riled up." Whatever the sentiment, there certainly were more IT-related comments across the board over the last year or two.

My initial thought was that the increased focus on cybersecurity might be impacting the regulators' conclusions. Then in other discussions with my associates, we thought that since credit quality issues were generally behind us, IT was naturally going to be the next point of focus for the examiners. While I think there is increased scrutiny in the area of cybersecurity, the timing does not seem to fit as that process is just now beginning. Having IT as the next regulatory point of focus didn't seem satisfying. There was no way to ever know that it was really the reason the banks were getting hammered. Also nothing really changed over the last few years to explain to the increase in poor exam results.

Based on many of the exam comments, I noticed a few recurring themes:

- **Risk Assessments** - While these assessments were present, the examiners were really "digging in" and asking a lot of "why" questions. When the banks could not answer the "whys," the conclusion implied by the comment was that the banks really didn't understand the risks. And if they didn't understand the risks, they could not appropriately address them.

- **Management Responsibilities** – Another way to say this might be "segregation of duties." Essentially, the exam reports pointed out situations where significant roles in Information Security or Operations were being performed by the same person. Another example was in situations where there seemed to be a figurehead named as the ISO, for instance, but those duties were effectively being performed by the CIO, CFO or even the president. In some extreme cases, the only remedy for these findings required the bank to hire employees or engage consultants to solve the issue.

- **Vendor Management** – Vendor management has been a hot topic for a while and there are a number of providers that help banks deal with the related administrative burden. Again, the best ways to describe the nature of the comments are the "why" and "how" questions. Why are certain vendors a higher risk than others? How did management reconcile findings in third-party audits? How does the bank know they included all key vendors? If management can't explain the "hows" and "whys," the entire process eventually loses credibility.

- **Repeat Findings** – No explanation needed here.

The general tone of many recent exam reports is that bank boards need to be more informed and involved in the entire risk management process, and the regulatory actions are continuing to force this issue. This is consistent with what colleagues are anecdotally seeing in their practices and in informal discussions with regulators. A March 2015 article which appeared in bankdirector.com noted that, "Regulators are now focusing on corporate governance and the role of directors to ensure banks have the right culture and controls to prevent excessive risk taking." It seems like that is what is happening now as IT is an area that carries increasingly significant risk.

This makes sense if you think about how examination results are not just a reflection on the management but also on the board, as they are ultimately responsible for corporate governance.

If you are a bank manager and have oversight responsibility for the IT function, it is critical to communicate to the board or appropriate committee, as often as practical, based on the bank's risk profile.

As a part of your periodic meetings, include discussions on:

- The top IT risks to your bank and how management is mitigating those risks; encourage questions from the directorate to ensure they really understand what's going on.

- The process for evaluating risks prior to making decisions for new initiatives or product roll outs, so that everyone knows which controls need to be adjusted for increased or changing risks.

- Prior examination result monitoring and plans/progress for resolution; repeat findings communicate that the bank is not taking the examination findings seriously.

If you are a bank board member, consider these items:

- Is the bank communicating what you need to know about the risks that are being taken?

- Do those risks seem to be aligned with the bank's general risk tolerance or risk appetite?

- Risk-taking is a necessary part of any banking operation, and if done correctly, it adds value to the bank.

- For your bank to stay competitive and grow in today's market, you will need to take on and manage risks that change over time. Those institutions that have well-defined risk management processes in place and appropriately involve their board of directors will not only fare better on the regulatory compliance front, but in the long run will make more sound decisions on the right mix of products and services to help guide their growth.

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Use Caution with Loans Secured by Holding Company Stock

By Mike Waters

A crucial element for a bank director's satisfaction of board duties is to be alert to regulatory issues that may impair the bank's safety and soundness and lead to regulatory sanctions. One area where this is particularly true is affiliate transactions. Sections 23A and 23B of the Federal Reserve Act and the Federal Reserve's Regulation W govern how a bank may engage in "covered transactions" with an "affiliate." This issue frequently arises when a bank makes a loan that is secured by the stock of the bank's holding company. An "affiliate" includes the bank's holding company or any company controlled by the holding company. A "covered transaction" covers many relations between a bank and its affiliates, including a loan or extension of credit to the affiliate; a purchase of securities issued by the affiliate; a purchase of assets from the affiliate and the issuance of a guarantee; acceptance or letter of credit on behalf of an affiliate. One covered transaction that is sometimes overlooked is the acceptance of securities of an affiliate as collateral for a loan by the bank to any person. Thus, if the bank lends money (or extends credit) to a borrower (even if the borrower is not related to the bank), and accepts holding company stock as collateral, that loan is a "covered transaction."

There are two issues here that a bank director or bank management should keep in mind when considering whether to approve a loan secured by holding company stock. The first is that there is a quantitative limitation on the amount of a bank's covered transactions with any one affiliate. Covered transactions with any one affiliate may not exceed 10 percent of the bank's capital stock and surplus. Essentially, "capital stock and surplus" means the bank's tier 1 and tier 2 capital based on the most recent CALL Report and the balance of the allowance for loan and lease losses not included in tier 2 capital and certain limited investments in financial subsidiaries. (There is also a limit on all affiliate transactions of 20 percent of the bank's capital stock and surplus.) The regulatory policy here is that affiliate transactions can involve enhanced risks for the bank and, therefore, the amount of affiliate transactions should be limited.

What is sometimes overlooked with loan transactions, however, is the second key issue the bank should be aware of. Because a "covered transaction" includes a loan to any person where the stock of the holding company is accepted as collateral, the 10 percent limit of covered transactions respecting any one affiliate applies to all loans where the holding company stock serves as collateral. In other words, if the bank makes loans to, for example, eight different unrelated borrowers, and the stock of the holding company is pledged by each borrower to secure each borrower's loan, the 10 percent limit applies to all eight loans in the aggregate.

There are, of course, other requirements under the affiliate transaction rules, such as collateral requirements for credit transactions, but the 10 percent limit on covered transactions with any affiliate could be a trap for the unwary when a board, loan committee, or loan officer is considering a loan secured by stock of the bank's holding company.

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Inching Towards a New Normal? Litigation Results from 2015

By Larry B. Childs and Christopher A. Driskill

As the economy continues to inch rather than leap forward, financial institutions continue to be targeted in all manner of ligation. The variety of results from litigation in 2015 demonstrate that while the economy may be inching towards more stability, you can never count on litigation to be "normal."

I. ALABAMA SUPREME COURT REVERSES EXORBITANT AWARDS FROM CIRCUIT COURT JUDGES.

Financial institutions that rely on jury waiver provisions to prevent runaway verdicts should take note of some of the rulings from bench trials in 2015, when two circuit court judges awarded multi-million dollar verdicts against banks.

In U.S. Bank Nat'l Ass'n v. Shepherd, Case No. 1140450, (Ala. Nov. 20, 2015), the Alabama Supreme Court reversed a $3.9 million judgment entered by the Lamar County Circuit Court after a bench trial.

The Shepherds owned three contiguous parcels of land (Parcels 1, 2 and 3). The Shepherds obtained a mortgage loan that they intended to secure with Parcel 1, but that was mistakenly secured with Parcel 2. When the servicer tried to collect on the debt it realized that the mortgage was erroneous, and filed a substitute mortgage in the probate court. The substitute mortgage, however, contained a legal description of Parcel 3 instead of Parcel 1. The servicer accelerated and foreclosed on the mortgage and published a foreclosure notice containing a legal description of Parcel 2. The servicer, however, took possession of Parcel 1. In 2011 the servicer filed suit to quiet title to Parcels 1, 2, and 3, and the Shepherds counterclaimed for negligence, wantonness, trespass, slander of title, and breach of contract, but later dropped all claims except for wantonness and trespass. After a bench trial the court entered a judgment in favor of the Shepherds on all counts and awarded the Shepherds $3.92 million in damages, which consisted of $80,000 in compensatory damages, $900,000 for mental anguish, and $2.94 million in punitive damages. On appeal the Alabama Supreme Court reversed, holding that the trial court should have reformed the mortgage to reflect the Shepherds' intention that Parcel 1 secure the loan, and that judgment on the Shepherds' trespass and wantonness claims was improper because the servicer acted within its legal rights in foreclosing on Parcel 1.

The case BB & T Co. v. Nichols, Case No. 1130631, (Ala. July 10, 2015), involved real estate developers who sought a "carried-interest" loan for a new development in Stapleton, Ala. The Nicholses testified that bank officers promised to restructure into a carried interest loan which included development costs if the Nicholses would borrow the money for the land purchase under a standard loan agreement and pay interest for two years, but the bank refused to restructure after the two years were up. The Nicholses sued the bank officers and the bank for fraud, wantonness, reformation, negligence, breach of fiduciary duty, breach of contract, unjust enrichment, and promissory estoppel. After a bench trial, the Baldwin County Circuit Court entered a judgment against the bank for $11.55 million. The Alabama Supreme Court reversed, holding that the alleged oral promises that formed the basis for the Nicholses' claims did not satisfy the Alabama Statute of Frauds. The Alabama Supreme Court rejected the Nicholses' argument that the alleged oral promise of conversion to a "carried

interest" development loan was included in the written loan documents because the documents stated that repayment was anticipated through future development of the Stapleton property.

Editor's note: The Alabama Bankers Association participated in both of these cases by submitting amicus briefs to the Alabama Supreme Court. The Court's opinions were consistent with the association's arguments in the briefs.

II. ELEVENTH CIRCUIT ALLOWS "AMBITIOUS" FAIR HOUSING CLAIM BY CITY OF MIAMI AND EXPANDS THE SCOPE OF FDCPA ACTIONS

In City of Miami v. Bank of America Corp., No. 14-14543, (11th Cir Sept. 1, 2015), the City of Miami brought what the Eleventh Circuit called an "ambitious fair housing lawsuit" against Bank of America. The Complaint alleged that the bank had engaged in both redlining and reverse-redlining, claiming that the bank refused to extend credit to minority borrowers, and then, if the bank did extend credit, it did so on "predatory" terms, and that bank's actions "caused minority-owned properties throughout Miami to fall into unnecessary or premature foreclosure, depriving the City of tax revenue and forcing it to spend more on municipal services . . ." The district court dismissed the complaint on two grounds: (1) the City lacked statutory standing under the FHA because it fell outside the statute's "zone of interests," which requires an FHA suit to be brought by "an aggrieved person," and (2) the City could not show proximate cause.

On appeal the Eleventh Circuit held that the City could proceed as "an aggrieved person" because it alleged an injury suffered as the result of a bank policy that was "either expressly motivated by racial discrimination or resulting in a disparate impact on minorities." The court further held that the City could pursue a claim because it was foreseeable that the alleged discriminatory lending would harm the City. The Eleventh Circuit's expansive interpretation of standing and lax standards for proximate cause mirror recent holdings from district courts in California in similar lawsuits.

In Miljkovic v. Shafritz & Dinkin, P.A., No. 14-13715 (11th Cir. June 30, 2015), the Eleventh Circuit ruled in an issue of first impression that representations made by an attorney in court filings during the course of debt-collection litigation are actionable under the FDCPA. The debtor had filed a claim for exemption from a writ or garnishment, asserting that he qualified as an exempt "head of family" under Florida law. The creditor's attorneys filed a sworn response disputing that claim. The debtor filed suit under the FDCPA. The district court dismissed the debtor's claim, holding that communications directed to someone other than the consumer are not actionable and expressing doubt that Congress intended to create potential FDCPA liability for "formulaic procedural filings" submitted in debt collection proceedings. The Eleventh Circuit reversed, holding that the "FDCPA applies to all litigating activities of debt-collecting attorneys," including statements made to a consumer's attorney in the course of litigation.


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New Alabama Residential Foreclosure Requirements

By Jeff Powell

Alabama law generally provides a right of redemption to various parties for one year after the date of a foreclosure sale. Effective Jan. 1, the redemption period was reduced to 180 days (note: not six months) for residential homestead property. The redemption period remains one year for all other property, including commercial property and all non-homestead residential property. If the property is being sold pursuant to a power of sale contained in a mortgage, then the mortgage must be dated on or after Jan. 1 to be subject to the new reduced redemption period. Therefore, if a mortgage, junior mortgage or judgment is dated prior to Jan. 1, the traditional one-year right of redemption period applies. The new law applies only for residential property, "on which a homestead exemption was claimed in the tax year during which the sale occurred. . ." Therefore, for any residential property on which a bank will foreclose, the bank should check the tax records to confirm whether the property had been claimed as homestead during the previous tax

year (Oct. 1 to Sept. 30). If such property is claimed as a homestead, additional requirements and procedures are required, as outlined below.

In addition to the traditional foreclosure rules under Alabama law, the lender foreclosing residential homestead property must provide written notice to the borrower "at the address of the property" at least 30 days prior to the foreclosure date, by certified mail with proof of mailing. In addition, the notice must contain the following disclosure:

Alabama law gives some persons who have an interest in property the right to redeem the property under certain circumstances. Programs may also exist that help persons avoid or delay the foreclosure process. An attorney should be consulted to understand these rights and programs as a part of the foreclosure process.

This same disclosure must also be included in the traditional foreclosure notice, which the lender must publish in the newspaper for three consecutive weeks prior to the foreclosure sale.

It is important to note that the notice must be mailed to the address of the property. While the new legislation only deals with homestead property, this notice provision assumes that the borrower resides at the property at the time of notice of foreclosure sale. This may not always be the case. Therefore, if the bank has reason to believe that the borrower has a different address, it would be prudent also to send the notice to any other address that the borrower is thought to possibly reside.

The 180-day period of time for redemption does not begin until notice has been provided as stated above, which includes both written notice to the borrower and notice by publication. Therefore, failure to provide proper notice means that the 180-day redemption period does not begin to run on the date of the foreclosure sale, and instead under the statute, it "shall not begin until notice is given in accordance with [the new law]." The new legislation does not provide any process to cure defective notice after a foreclosure sale, which could delay the start of the redemption period indefinitely. However, the new law provides that "all actions related to the notice requirement must be brought within two years after the date of foreclosure, or the action shall be barred." Therefore, such time bar should be sufficient to cut off any right of redemption two years after the date of foreclosure, even if notice was not properly given, but the new law does not expressly so state.

The statute does indicate that defective notice, or even the failure to give any notice, does not affect the validity of the foreclosure itself, including the transfer of title to the property. While this provision is very important, the law still leaves somewhat uncertain the question of when a lender (or subsequent purchasers of property) can be confident that the right of redemption has expired, if notice was not given in compliance with the new requirements. With these new requirements, lenders in Alabama should modify their procedures and policy requirements. Any foreclosure sale of residential property should be carefully reviewed for compliance with these new requirements.

Jeff Powell is a member of Bradley Arant Boult Cummings' Banking and Financial Services Practice Group and is focused on advising financial institutions on corporate, compliance, operational and regulatory matters.

Captive Insurance Companies Offer Tax Benefits

By Jenny McCain

A captive insurance company is an insurance company that is created by the parent holding company to underwrite the insurance needs of its subsidiary operating affiliates. Large organizations and businesses have used captive insurance companies for years. Recently, financial institutions have begun to take advantage of the tax benefits available for captive arrangements.

A captive insurance company's main business purpose is to insure the risks of its owners or companies affiliated with the owners through ownership, management or control on a tax-exempt basis, assuming the captive is properly structured. A captive insurance company can provide virtually any type of insurance, as long as the laws of the domicile state allow the lines of business to be underwritten. Often institutions design a captive program to be in addition to their current insurance program, to plug gaps in current policies or to cover higher deductibles in certain coverages. The captive program doesn't replace their current insurance coverage or risk program. The captive program is in addition to those policies.

A pooled captive arrangement is a captive in which multiple single parent captives enter into a risk sharing agreement to spread the risk of losses in order to minimize the impact of an individual loss to any one captive. Some of the types of insurance provided by captives include general and umbrella liability, reputational risk, employment practices liability, cybersecurity, trust liability, fiduciary liability, error and omissions, and property damage/business interruption. One of the benefits of a properly set-up and structured captive is that the company may receive a federal and state tax deduction for the payment of the insurance premiums and the captive also is taxed favorably as an insurance company for federal income tax purposes. An explanation of the specific tax rules and regulations governing captive insurance companies is beyond the scope of this article.

A bank holding company must become a financial holding company (FHC) to form and operate a captive insurance company. Financial holding companies are a type of bank holding company created by the Gramm-Leach-Bliley Act of 1999. To qualify for FHC status, a bank holding company and each of its bank subsidiaries must be "well capitalized" and "well managed" and each of the holding company's bank subsidiaries must have received a "satisfactory" rating at its most recent CRA exam.

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Giving Away the Farm: Director Liability for Overly Generous Employment Agreements

By Gilbert C. Steindorff IV

Directors of banks and other corporations are responsible for many important decisions that call upon their professional judgment. Directors' decisions often have a direct impact on the profitability and risk profile of the corporation and, while directors are held to a high standard of judgment, the law does not require perfection or clairvoyance on behalf of directors. If bank directors were personally liable for each unforeseen

or miscalculated consequence of a decision, no one would ever agree to serve on a board of directors. Perhaps the most well-known protection available to bank directors under the law is the "business judgment rule," which, in its simplest form, prevents would-be litigants from hanging directors "out to dry" in every instance when directors' best intentions do not bring about the desired result. In some states, the business judgment rule is actually codified by statute; however, in Alabama, the business judgment rule as applied to directors of a corporation is a creature of common law.

In Alabama law, most modern cases concerning the business judgment rule rely on the reasoning of the Supreme Court of Alabama in 1992 in Michaud v. Morris which articulates the business judgment rule as follows:

If in the course of management, directors arrive at a decision, within the corporation's powers ... for which there is a reasonable basis, and they act in good faith, as the result of their independent discretion and judgment, and uninfluenced by any consideration other than what they honestly believe to be the best interest of the corporation, a court will not interfere with internal management and substitute its judgment for that of the directors to enjoin or set aside the transaction or to surcharge the directors for any resulting loss.

Directors' protection under the business judgment rule is not absolute, however, because if a court finds the existence of either bad faith or the absence of a "reasonable basis," the business judgment rule defense is disallowed and the court will indeed second-guess the directors' decisions as it did in 2005 in Hensley v. Poole.

One specific context in which directors have faced personal liability under Alabama law for their actions and been denied the protection of the business judgment rule is in the area of executive compensation. As in other states, employment contracts for certain key executives are not uncommon among Alabama banks, and are often viewed as an effective mechanism to attract and retain top talent for key positions within the bank. These contracts may guarantee minimum salaries or performance-based initiatives for an executive, and may further guarantee that an executive's employment will not be terminated for a stated number of years unless "for cause" due to specific infractions.

While directors may be well-intentioned in their desire to attract better management for their bank by offering favorable employment contracts, it is possible for executive employment contracts to be overly generous to the point of imposing personal liability upon the directors that agreed to the contract.

Problems associated with overly-generous executive employment contracts generally do not surface until the bank has already incurred a loss, either due to poor decision-making by the executive or due to an excessive burden to its profitability to provide the compensation guaranteed by the contract. In evaluating whether directors' decisions concerning executive compensation are subject to protection under the business judgment rule, Alabama courts will inquire whether the compensation "is so excessive" or the terms so favorable to the executive that "[they] bear no reasonable relation to the value of services rendered." When evaluating the "reasonable relation" of the terms of an executive employment agreement to the "value of services rendered," Alabama courts inquire whether the terms are "in proportion to the executive's ability, services and time devoted to the company, difficulties involved, responsibilities assumed, success achieved, amounts under jurisdiction, corporate earnings, profits and prosperity, increase in volume or quality of business or both and all

other relevant facts and circumstances."

The possibility of personal liability for offering overly-generous employment contracts should be a present consideration by directors when attempting to strike a balance between attracting the best talent and imposing too great a potential burden on their bank. Directors should exercise great care in determining what amount of guaranteed compensation is appropriate and, in particular, how long of a term of employment is acceptable to the bank. Even if an executive arguably may be overcompensated or may prove to be less stellar a manager than promised, limiting the guaranteed length of employment to a reasonable period of time ideally provides the bank with a safety valve either to renegotiate terms or to replace the executive if necessary before he or she inflicts too much damage on the institution.

Finally, it is worth noting that, while executives tend to prefer the security of an employment agreement, such agreements are still a privilege and not a right. As the CEO of a billion-dollar Alabama financial institution with no employment agreement recently told me, "I'm only as good as my last board meeting."

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Alabama Economic Report

By Michael Stone

A comprehensive look at Alabama's economic climate shows that while Alabama has not quite recovered from the Great Recession as measured by number of persons employed pre- and post-recession, there are some positive signs that the state's economy has picked up in recent months. Through Sept. 30, 2015, Alabama's gross domestic product (GDP) grew 2.2 percent compared to the same period in 2014, outpacing 30 states and only slightly lower than the overall U.S. GDP growth rate (2.5 percent).

Population and Income Growth

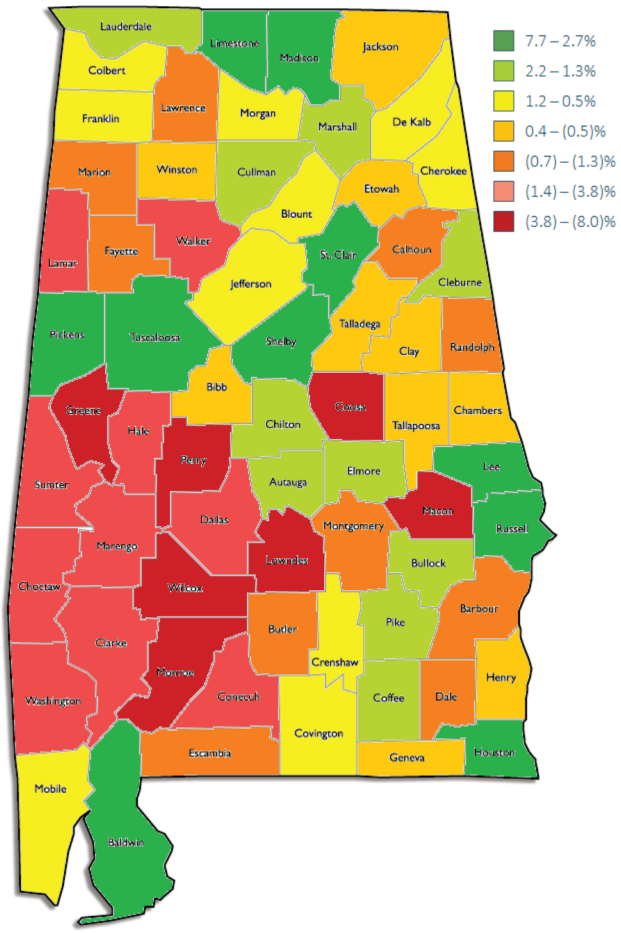
Jobs are the most important indicator of economic conditions. Jobs produce income, attract in-migration and stimulate population growth. Increasing the number and quality of jobs available in a geographical area is absolutely essential to economic growth. We highlight two economic indicators driven by jobs: population and income.

The table below provides a snapshot of Alabama's population (ranked by county size) and historical population growth rate by county over the last five years. Russell County has seen the largest population growth (15.6 percent), while neighboring Macon County has seen the largest decline. The smallest counties have experienced the largest declines on average, and the two largest counties (Jefferson and Mobile) have been stagnant. The state grew by less than 2 percent over the last five years, less than half of the U.S.'s growth rate of 4.4 percent. More than half (39) of Alabama's 67 counties declined during the last five years, and 35 of those declining counties are projected to continue to decline over the next five years. The following color-coded map displays the projected five year population growth by county. The smallest counties (all in the southwestern part of the state) are projected to continue to decline over the next five years.

Historical Population and Recent Growth

County	Population	Growth (5 Yr)	County	Population	Growth (5 Yr)
Jefferson	662,528	0.62%	Pike	33,431	1.62%
Mobile	415,990	0.73%	Lawrence	33,240	-3.20%
Madison	355,615	6.21%	Franklin	31,583	-0.38%
Montgomery	224,238	-2.23%	Marion	30,111	-2.16%
Shelby	210,746	8.03%	Barbour	26,709	-2.72%
Baldwin	206,915	13.52%	Geneva	26,627	-0.61%
Tuscaloosa	204,793	5.21%	Cherokee	26,014	0.10%
Lee	158,884	13.29%	Clarke	24,663	-4.53%
Morgan	119,500	0.01%	Winston	24,076	-1.67%
Calhoun	114,967	-3.04%	Bibb	22,419	-2.16%
Houston	105,016	3.42%	Randolph	22,402	-2.23%
Etowah	103,043	-1.33%	Monroe	21,528	-6.68%
Marshall	94,961	2.09%	Pickens	21,111	6.91%
Limestone	93,492	12.94%	Butler	20,175	-3.69%
Lauderdale	93,387	0.73%	Marengo	19,848	-5.61%
St. Clair	87,730	4.95%	Macon	18,672	-12.96%
Cullman	81,839	1.78%	Henry	17,128	-1.01%
Elmore	81,428	2.68%	Fayette	16,783	-2.66%
Talladega	81,074	-1.48%	Washington	16,660	-5.24%
DeKalb	71,113	0.01%	Cleburne	15,159	1.25%
Walker	64,931	-3.12%	Hale	15,026	-4.66%
Russell	61,213	15.61%	Crenshaw	13,999	0.67%
Blount	57,755	0.76%	Lamar	13,944	-4.26%
Autauga	55,622	1.93%	Clay	13,537	-2.84%
Colbert	54,600	0.32%	Choctaw	13,170	-4.97%
Jackson	52,370	-1.61%	Sumter	12,960	-5.83%
Coffee	51,012	2.13%	Conecuh	12,416	-6.14%
Dale	49,053	-2.38%	Wilcox	10,881	-6.76%
Chilton	44,059	0.95%	Bullock	10,860	-0.49%
Tallapoosa	41,072	-1.31%	Coosa	10,631	-7.87%
Dallas	40,978	-6.49%	Lowndes	10,338	-8.51%
Covington	37,954	0.50%	Perry	9,554	-9.79%
Escambia	37,501	-2.13%	Greene	8,354	-7.64%
Chambers	34,041	-0.51%	Total	4,873,429	1.96%
			U.S.	332,431,073	4.43%

Projected 5 Year Population Growth by County



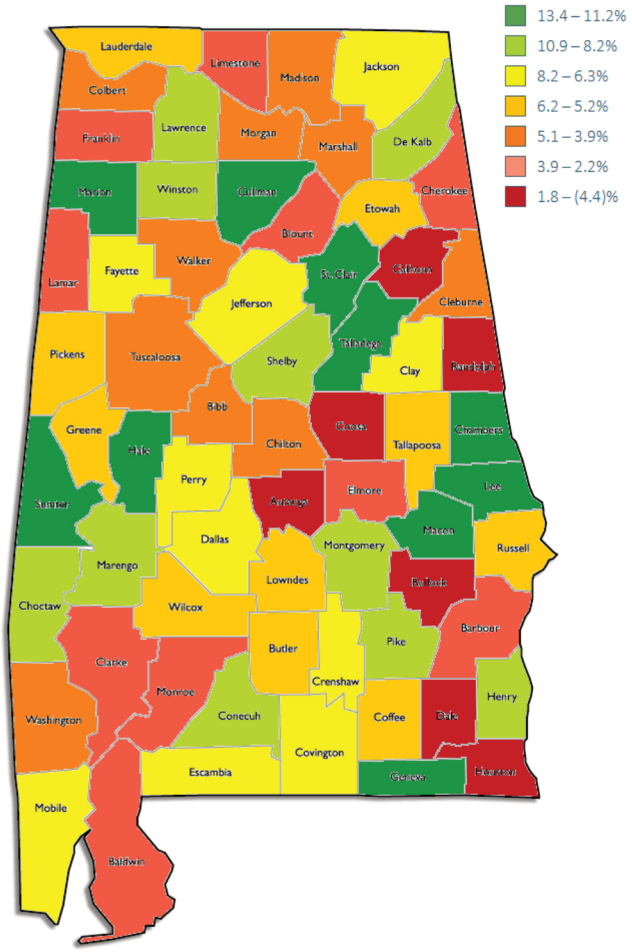
Note: All chart data courtesy of Nielsen, the Federal Reserve, or U.S. Departments of Labor and Commerce.

Household income (HHI) is a good barometer for job quality and consumer buying power. The following table provides a snapshot of the median HHI by county. Shelby County has the highest median HHI ($71,564) while Greene County has the lowest ($25,013). Only three counties (Shelby, Madison, and Saint Clair) have a higher median HHI than the national average. The following color-coded map shows the projected five year median HHI growth by county. Hale County is projected to experience the largest growth in HHI (13.4 percent) while three counties (Calhoun, Coosa, and Autauga) are projected to decline in HHI.

Median HHI by County

#	County	HHI ($)	#	County	HHI ($)
1	Shelby	$ 71,584	35	Russell	$ 37,833
2	Madison	59,688	36	Bibb	37,757
3	St. Clair	57,340	37	Covington	37,676
4	Elmore	53,037	38	Lamar	37,524
5	Autauga	51,647	39	Choctaw	37,032
6	Lee	48,927	40	Calhoun	36,469
7	Limestone	48,435	41	Franklin	36,399
8	Baldwin	47,999	42	Clay	36,015
9	Jefferson	47,686	43	Chambers	35,986
10	Montgomery	46,984	44	Pike	35,963
11	Tuscaloosa	46,515	45	Cherokee	35,827
12	Coffee	46,483	46	Walker	35,779
13	Henry	45,544	47	Coosa	35,587
14	Morgan	45,508	48	Fayette	35,444
15	Blount	45,486	49	Randolph	35,143
16	Lauderdale	44,943	50	Marion	34,494
17	Mobile	44,660	51	Winston	34,429
18	Cullman	43,842	52	Bullock	34,252
19	Washington	43,577	53	Macon	33,867
20	Dale	43,447	54	Hale	33,598
21	Chilton	43,297	55	Barbour	33,313
22	DeKalb	42,188	56	Escambia	32,691
23	Lawrence	42,120	57	Butler	31,553
24	Tallapoosa	41,359	58	Pickens	30,934
25	Colbert	41,133	59	Clarke	30,144
26	Jackson	40,842	60	Monroe	30,010
27	Houston	40,610	61	Perry	29,297
28	Cleburne	39,708	62	Dallas	28,784
29	Etowah	39,642	63	Lowndes	27,934
30	Marshall	39,424	64	Conecuh	26,697
31	Talladega	38,940	65	Wilcox	25,059
32	Geneva	38,800	66	Sumter	25,050
33	Crenshaw	38,643	67	Greene	25,013
34	Marengo	38,251		State Avg.	$ 45,107
				U.S. Avg.	$ 55,551

Projected 5 Year HHI Growth by County

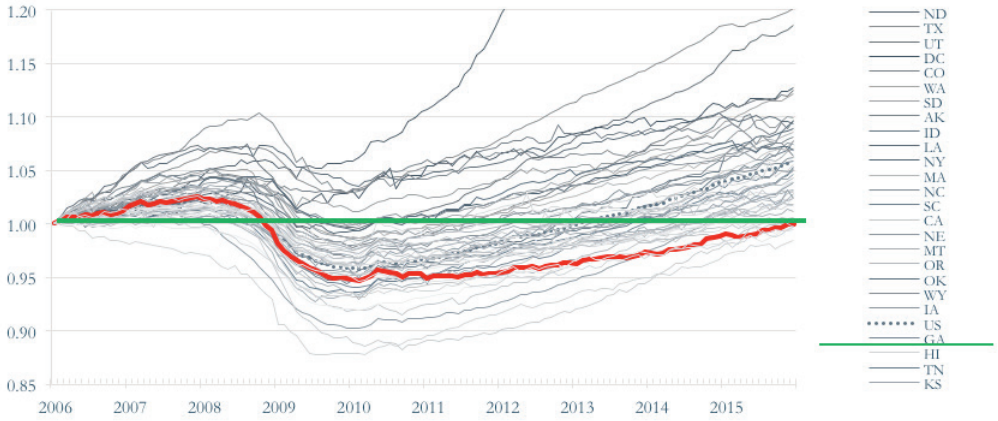


State Employment Activity

Ending December 31, 2015

Employment, and the change in number of people employed, is the most important indicator of the health of an economy. People move or return home to a place that offers them meaningful jobs.

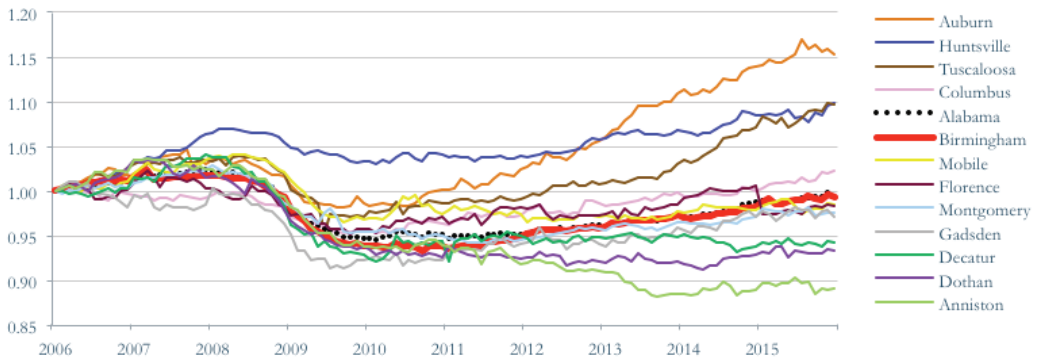
Total Employment (Indexed) – Alabama vs. Other States



As shown in the figure to the right, Alabama has lagged 44 states in total employment from January 2006 to December 2015. The chart is sorted by total employment growth since January 2006, moving from left to right down the legend (largest – North Dakota, 2nd largest – Texas, smallest – Michigan). The states that are listed in the table in red have not reached January 2006 employment levels.

Within Alabama, the Auburn-Opelika MSA has seen the largest total employment growth, while Anniston-Oxford MSA has seen the largest decline. The following chart is sorted by total employment growth since January 2006. Only four MSAs in Alabama (Auburn, Huntsville, Tuscaloosa, and Columbus) have reached January 2006 levels.

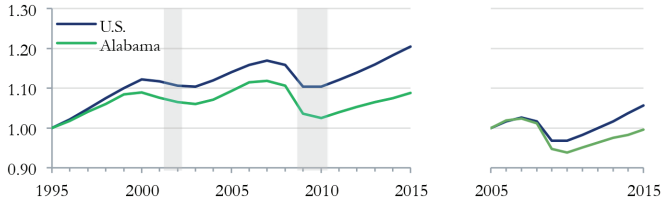
Total Employment (Indexed) – Comparison of Alabama MSAs



State Economic Activity

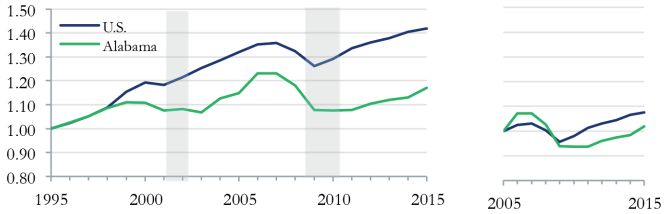
Ending September 30, 2015

Total Employment (Indexed) – Alabama vs. United States



	Sep-14	Sep-15	Percent Change
US	139.9 M	142.5 M	1.9%
AL	1.93 M	1.96 M	1.4%

Retail Sales (Indexed) – Alabama vs. United States



	LTM Sep-14	LTM Sep-15	Percent Change
US	$3.96 T	$4.00 T	1.0%
AL	$59.6 B	$61.8 B	3.7%

EMPLOYMENT

As of Sept. 30, 2015, the number of people employed in the United States had recovered to the previous high level (although the percentage of population in the labor force was still at a post-recession low). In Alabama, however, the number of people employed has not reached full recovery, and the rate of growth is lagging behind the U.S. as a whole.

RETAIL SALES

Retail sales are important in Alabama as a sign of economic activity and an important source of governmental revenue from sales taxes. For the recent 12-month period, Alabama has outpaced the rate of growth of the U.S., using personal consumption of durable and non-durable goods (omitting personal services) as the analog for U.S. sales.

Summary

Alabama's economy continues to improve steadily but still lags the U.S. in employment and population growth. Economists, as reported by Nielsen, estimate that this trend will continue over the next five years, both in terms of population growth and median income levels. While total employment has improved in Alabama, higher manufacturing jobs have been replaced with lower paying service jobs, reducing the consumer buying power in the state. Dependence on large employers in some of Alabama's smaller counties continues to pose a risk to both the municipalities that need tax revenue to provide critical services and the residents who solely rely on these companies for employment. Countering significant reductions in the mining industry, all other industry sectors in Alabama increased GDP output year-over-year, led by the agriculture and healthcare sectors. Despite uneven growth throughout the state, Alabama's total GDP has continuously grown (year-over-year) for the last eleven quarters, signaling Alabama's slow but steady recovery.

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