

in sights

Succession Planning for Banks and Small Businesses

July 2014

Presented by:

Executive Benefits Network
626 East Wisconsin Ave , Suite 1000
Milwaukee, WI 53202
Phone 414.431.3999
Fax 414.431.9689
ebn-design.com



Knowledge You Can Bank On™

Agenda

- I. Background
- II. Challenges
- III. Why a Business Succession Plan?
 - A. Leadership Succession
 - B. Estate Planning
 - C. Retirement Planning
 - D. Harmony
- IV. Examples
- V. Best Practices
- VI. Question & Answer



R. David Fritz, Jr., CLU®
Managing Partner,
Co-Founder
Office (414)431-9688
dfritz@ebn-design.com



Patrick J. Marget, JD, CPA,
CFP®, CLU®
Managing Director
Office (414) 431-9681
pmarget@ebn-design.com

“A recent wave of high-profile executive departures highlights the need for boards to regularly review succession plans and develop future leaders in an environment where it is getting increasingly difficult to find well-trained talent.”

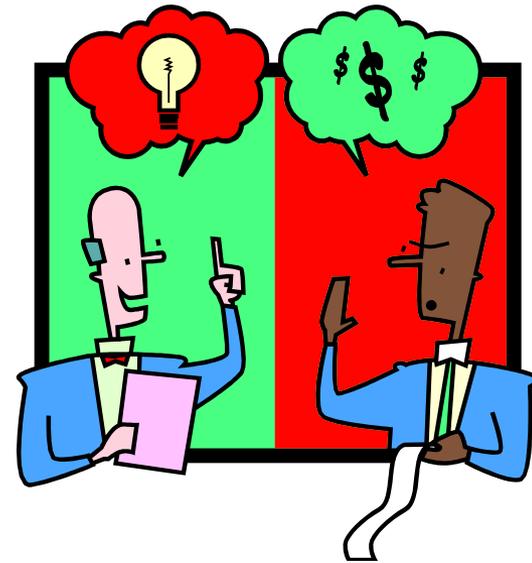
-American Banker

AMERICAN BANKER.
magazine

Challenges

- Financial crisis- “bunker” mentality
- Reluctance to retire- sense of dedication or worry
- The psychology that banking is “bad”
- Negative connotations of succession planning
 - “Don’t have the time”
 - Signing their own death warrant
- Number of family owned banks...
 - That make it to the second generation: 30%
 - That make it to the third generation: 12-15%

(American Institute of Management, IA)
- Rural Depopulation



Why a Business Succession Plan?

A detailed, well communicated business succession plan:

- Creates a legacy as both a business owner and community leader
- Identifies strengths, weaknesses and recruiting opportunities of the business
- Allows for orderly transitions– helping employees and customers
- Provides answers to the following:

I. Leadership Succession	Who is the right person to run the business when I cannot?
II. Estate Planning	Who do I want taken care of? What is the most tax-friendly way to do this?
III. Retirement Planning	Can savings for retirement outside of the business help me?
IV. Harmony	How can I “keep the peace”?

- Communication is key– a plan no one knows about is no good.

Poll #1:

Do you have a formal leadership and business succession plan?

Yes- 22%

No- 78%

I. Leadership Succession

Who is the right person to run the business when I cannot?

- Without leadership succession, the other aspects become irrelevant
- This person selected dictates the structure of the plan:
 - Family member: incorporated into overall estate plan
 - Employee or another current owner: use a buy/selling plan
 - Outsider (competitor or professional private equity company): use the sale of the business
- After determining who should run the business, determine if this person should also own the business.
 - Generally, this answer is YES
 - Example: Parent of three children
- “Golden Handcuffs”
 - For those critical to the success of the business
 - Builds long term harmony

“Companies that promote from within often outperform those that recruit outsiders.”

– Indiana University and A.T. Kearney



II. Estate Planning

Who do I want taken care of? What is the most tax-friendly way to do this?

- These questions are answered by:
 - Transferring the right property to the right people at the right time
 - Making sure the right people are making decisions when you cannot
- Business owners that want to give a highly valuable business to a successor will find the estate tax to be an obstacle
- Two critical components of a succession plan:
 - Tax planning
 - Asset protection planning
- Tools that help resolve estate tax issues and allow the business owner time to focus on retirement and the people he or she cares about are numerous:
 - Trusts
 - Buy/Sell Arrangements
 - Life Insurance
 - Charitable Planning

Poll #2:

Do you have a comprehensive retirement plan in place (including qualified plans, nonqualified plans, stock liquidity, etc.)?

Yes- 57%

No- 43%

III. Retirement Planning

Can savings for retirement outside of the business help me?

- Some business owners place no priority on retirement planning and cannot foresee themselves not involved in the business.
- Most closely held business owners reinvest all of the business' profits back into the business.
 - PROBLEM: The only source of retirement income is the business itself; however, the businesses' income also has to provide for the new owner as well as future expansion and reinvestment.
- Oftentimes, business owners are so frustrated when it comes time to retire that their retirement plan gets in the way of successful business ownership succession.
 - PROBLEM: The successor is less excited to take over and run a business burdened by the previous owner's retirement needs.
- Early savings for retirement outside of the business is important. Why?
 - ANSWER: Outside investments give the business owner something incredibly valuable: flexibility and choices. The owner will be glad for these choices when retiring and when transitioning leadership.

IV. Harmony

How can I “keep the peace”?

- Maximized when everyone is happy
- Determine what people want AND balance what is fair
- Be honest with yourself and others involved
- Person currently working at the business and adding value VS. uninvolved person
- Risk associated with running the business
- When family is involved:
 - Cooperation
 - Equal ownership interests passively: requires trust and may not last forever
 - Compensate the inactive heirs
 - Liquidity: Earnings on retained capital will typically be taxed at higher rates for entities vs. individual owners
- Life Insurance: tool to “equalize” the estate and get everyone what they want
 - ie: Uninvolved people get income tax-free cash



Examples

Example 1:

A community bank located in a rural setting has a CEO who would like to retire in the next 5 years. The Board does not feel using a search firm will yield a long term solution to filling the leadership void.

Based on this viewpoint, the bank chooses to look inside its current key employee ranks to identify the best candidate(s) to groom to be the successor. The bank will utilize outside resources such as industry-based educational initiatives coupled with internal expansion of involvement at Board meetings, CEO job shadowing and increased bank responsibilities. Once determined this is correct successor, bank will tie executive into bank with a deferred compensation plan.

Examples

Example 2:

In a family-owned business passing on to the third generation, each family may have a different number of children. Conflicts can arise between siblings and cousins, and ownership interests may be weighted towards one family depending on how the original interests were divided.

Detailed and thoughtful succession planning will provide a solution to this devolution of interests according to the considered desires of the original owners. Provisions may also be included to allow for revision of this plan in a well ordered and agreed upon manner.

Examples

Example 3:

A community bank is owned 51% by the CEO and his family, and 49% by a non-employed Director. The bank has no current buy-sell plan in place. Controlling shareholder would like to redeem the shares of the minority owner in the event of his death.

Owners agree a formal buy-sell agreement should be executed to provide clarity to the families. The owners determine life insurance should be purchased to provide liquidity to the bank to redeem minority shareholder's interest and to provide controlling family liquidity to deal with the potential estate tax liability.

Best Practices

1. Accepted by all owners/directors and provides guidelines for continuation beyond those owners/directors
 - Hiring Practices
 - Handling Employee Challenges
 - Aligning workforce with business goals
2. Directors' responsibility to select the new leader
 - “Active conversation” with the board
 - Quarterly (Monthly if three years from retirement age)
3. Have an emergency plan
4. Develop talent internally
 - Real commitment
 - Succession Planning vs. Talent Development
 - Higher retirement age of banks sold (Age 65)
 - Special projects, committees, industry conferences
 - Expose a wider group to management projects
5. Support of the current CEO

What are Regulators Saying?

1. Regulators are looking at Succession Plans in each exam and include comments in the Management Report
2. Most of the attention is placed on the CEO succession; however, scope is widening
 - Critical roles are included: CFO, CIO, chief lenders
3. Smaller, rural institutions – challenge to recruit talent
 - Strong suggestion to grow your own talent
 - Suggest targeting local young adults who are returning to town from college as candidates
4. Board replacements are part of succession planning analysis
 - What new skills and talents do you need from Board members?
 - Director Liability – greater expectations of time and role
 - Director Compensation – does it reflect the time commitment and liability adequately?

EBN Takeaways

- Communicate. A plan is no good if no one knows it exists.
- Have a plan that incorporates everyone from start to finish.
- Work with an experienced team of trusted advisors, attorneys, CPA's, financial advisors and bankers to make the process significantly smoother~ 1% of capital per year.
- Do not separate ownership and leadership.
- Trusts, buy/sell arrangements, leases, charitable planning, etc. are tools that can help resolve estate tax issues.
- Investing outside the business will give the owner choices.
- Focus on what people want and what is fair.
- Review and revise periodically– life is not stagnant, and changes will need to be made to stay current with your goals and dreams.

Additional Resources

- EBN Insights
 - Whitepapers
 - Webinars
 - News Updates
 - Events
- Monthly EBN Newsletter
- Coming Soon
 - Case Studies

The screenshot shows the EBN website interface. At the top, the URL 'ebn-design.com' is visible. The EBN logo (Executive Benefits Network) is on the left, with the tagline 'Knowledge You Can Bank On™' to its right. Navigation links for 'Client Login', 'Contact Us', and 'Locations' are on the far right. A dark blue navigation bar contains four dropdown menus: 'Who We Are', 'Banking Services', 'Executive Benefits Services', and 'Resource Center'. The main content area features a large banner for a whitepaper titled 'Succession Planning for Family-Owned Banks and Businesses'. The banner includes the EBN logo and the word 'insights' in orange. Text on the banner describes the whitepaper's content and provides a 'Download Now' button. Below the banner is a yellow notification bar for a webinar: 'Bank Compensation and Nonqualified Executive Benefit Plan Study Webinar- May 21 at 1pm. Sign up HERE!'. At the bottom, a dark blue bar contains three categories: 'From the Blog', 'News Updates', and 'Events'. Under 'From the Blog', there are three article teasers: 'The Pickle of Term vs. Perm' by Nikki Kook, 'Planning with Non-Profit Organizations', and 'Common Oversights in Split-Dollar Plans'.

Thank You!

To receive a copy of this presentation, please contact Nikki at nkook@ebn-design.com

Sign up for our newsletter to be alerted of more EBN Insights on our website www.ebn-design.com

