



Vol. V, No. 13

December 2010

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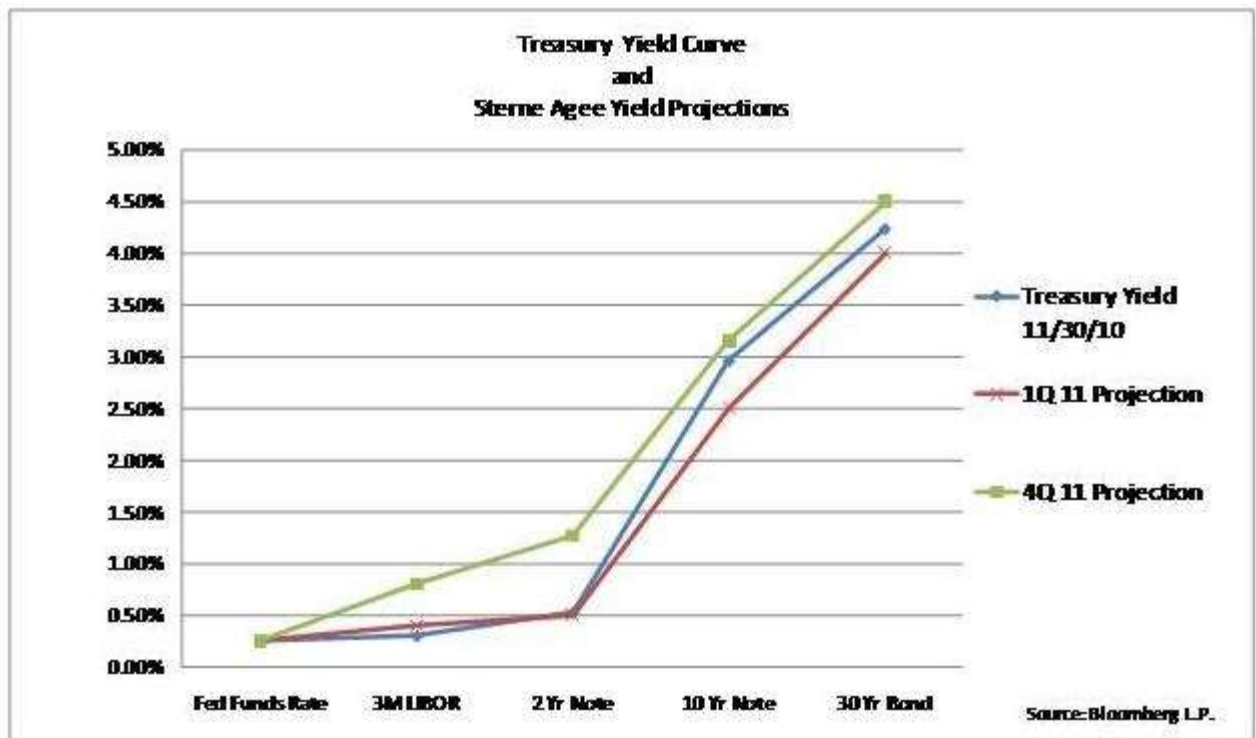
INDEX RETURNS (YTD%) as of November 2010	
ABAQ	-1.27
NASDAQ Composite	11.06
S&P 500	5.87
Russell 3000	9.51
KBW	6.21
ABQI*	-2.38
QABA*	-1.69
*Since Inception	

**Bond Market Update:
~~ A Head Fake for the Bond Market?**

by Sharon Lee Stark, Head of Fixed Income Strategies, Sterne Agee

It is always interesting to watch the reaction of investors and the press as we come out of an economic recession. Any hint of a positive trend becomes the beginning of a recovery and projections for faster growth soon follow. The response to improved spending and employment conditions the past year follows the pattern of previous market behavior; however, one must remember that all data is relative. Real GDP growth posted a 2.5 percent pace in the third quarter, following a negative to sluggish 1.5 percent rate a year ago. Payrolls have finally stopped shrinking, but average monthly job growth of 150,000 is just enough to keep the unemployment rate at an elevated 9.5 percent. The housing market remains the Achilles heel of this "recovery" with median home prices in a persistent decline and home resales, which now comprise 90 percent of all home sales, dominated by foreclosure sales.

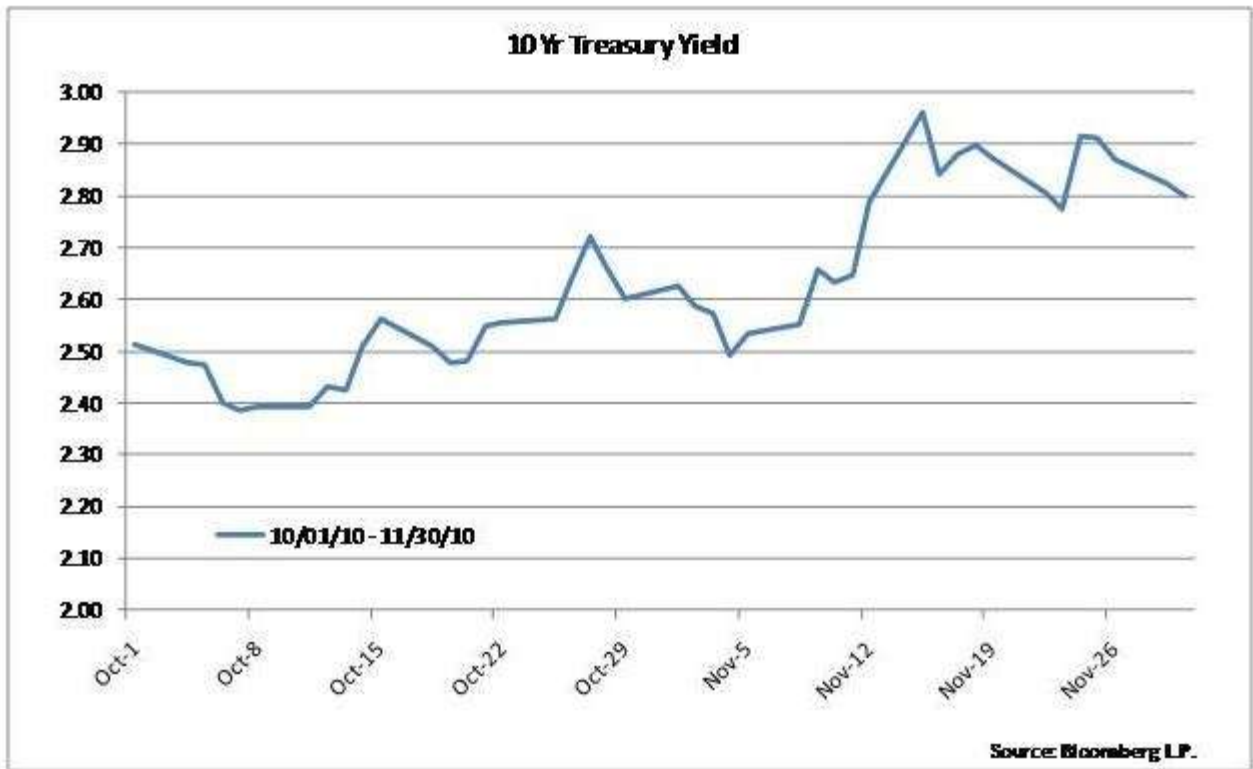
And of course there is politics. Some would argue that the results of the mid-term elections reflect the frustration of Americans who do not believe the current Congress is doing enough to stimulate growth and generate jobs. Whether or not that is the case, the issue at hand is can a divided Congress work with a Democratic administration to enact the necessary policies to encourage economic growth? Appropriate fiscal policy is a key factor in the ability of the economy to embark on a sustainable growth pattern. Gridlock is a serious risk to the ability of the economy to "get over the hump." As evidenced by the first round of quantitative easing, monetary policy alone will not encourage spending and capital investment; the U.S. economy needs fiscal assistance from both domestic and foreign policy makers. All the stars need to be perfectly aligned to orchestrate a solid economic recovery. *While these politicians figure it out, the bond market is already anticipating success and has begun to position for accelerating inflation and higher interest rates in the next quarter. Will the bond market be a victim of a head fake?*



Fed Under Fire

The response to the Fed's announcement of a second round of asset purchases as part of an unorthodox strategy to hold interest rates down caught Fed officials off guard. Some Congressional representatives believe the additional \$600 billion purchases are unnecessary and will only fuel inflation pressures. Foreign officials also put forth strong opposition to the program, with some going so far as to accuse the Fed of working with the Treasury Department to intentionally weaken the dollar in an effort to reduce the U.S. trade gap with countries such as China. The attacks, coupled with criticism from foreign officials, have introduced enough uncertainty into global financial markets to potentially undermine the Fed's plan to drive down interest rates.

Since the November 3rd announcement, Treasury yields have risen in response to criticism of the proposed Fed action. The yield on the 10-year Treasury note, at 2.67 percent on Nov. 3, fell to 2.53 percent on November 5th. Then came a reversal that caught traders by surprise. Yields soared on November 15th, most likely a result of heightened/imaginary inflation fears and optimism for faster economic growth. The yield on the 10-year note was up to 2.96 percent by November 15th before retreating to 2.79 percent by the end of November. It is our belief market participants over reacted to the foreign criticism which led to speculation that overseas investors would reduce U.S. debt holdings to protect against dollar weakness. A reported increase in consumer spending and press reports of solid holiday shopping volume fanned imaginary inflation fears; none of which have markedly materialized at this point.

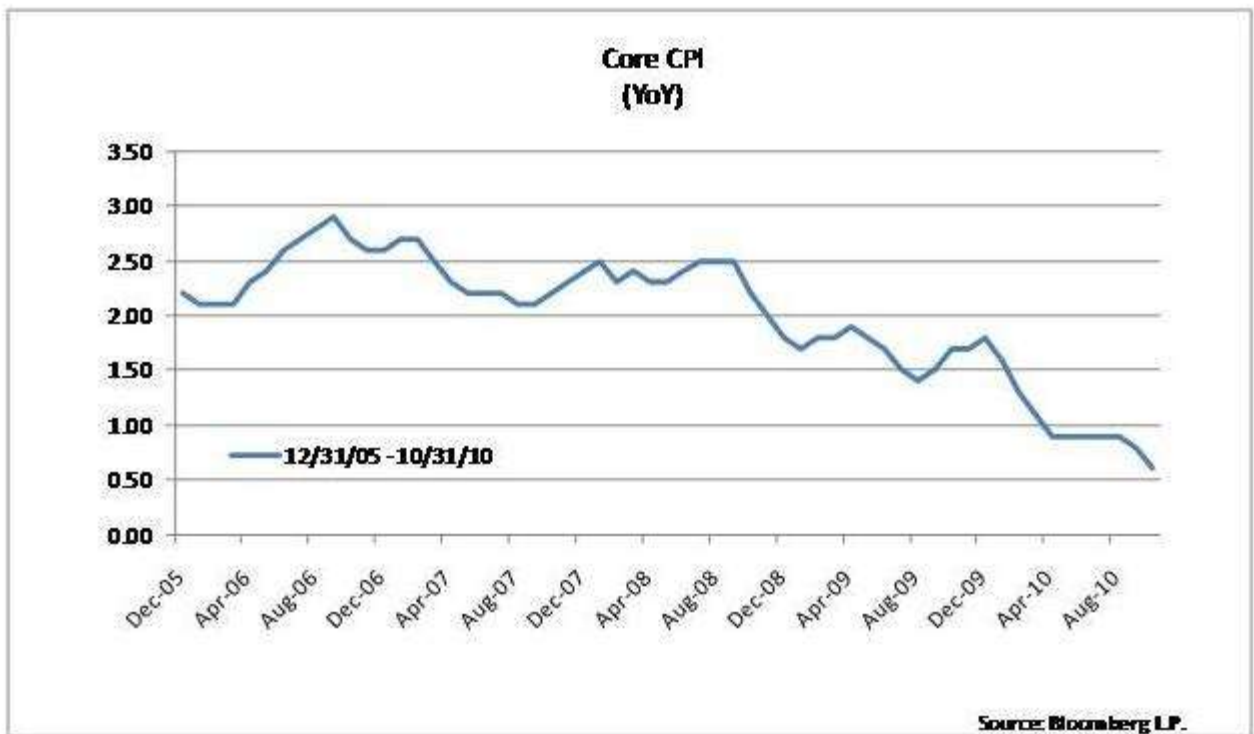


Inflation or Lack Thereof

A closer review of various inflation indicators highlights the reasons behind the Fed's decision to implement another round of quantitative easing. With interest rates near zero, the purchase of Treasury securities as a means to reduce long term rates appears to be appropriate policy as the U.S. economy struggles to recover and prices continue to fall. Data suggests that with the exception of gasoline and medical costs, prices for goods, services and labor are all deflating.

Prices for goods and services have been flat to lower over the past three months. The overall CPI rose 1 percent from a year ago October, and was up a mere 0.2 percent for the month. Home prices, which account for 42 percent of the index, were just 0.1 percent higher in October, the first gain in two months, but remain negative on a year-over-year basis. Prices for all sectors of the housing market, including rentals, furnishings, and lodging away from home were either lower or unchanged.

The core CPI, which excludes food and energy prices, has registered a zero percent month to month change for the three months ended in October. From a year ago, core inflation decelerated to 0.6 percent, the lowest reading since 1957 when the government began keeping statistics. *Now we have an understanding of why the Fed is concerned about disinflation.*



The core CPI excluding shelter prices, one of the largest components of the index, registered a 0.5 percent drop in October, the second consecutive monthly decline. The last time this occurred was in December 2008, shortly after the global financial markets imploded. With a persistent three month decline in the shelter index, the core CPI excluding shelter is growing at a paltry 1.3 percent year-over-year pace.

Signs of deflation are also flashing about with new car prices having fallen for two consecutive months, and appliance and furniture prices down for four and five consecutive months respectively. The cost of electronics is in a persistent decline and education prices are down 0.5 percent on an annualized three-month rate.

As prices for goods and services decelerate, unit labor costs are also falling. After reaching a 10-year peak of 3.9 percent in the year 2000, the cost of labor has deflated to a negative 1.6 percent pace at year end 2009 and is currently down 1.9 percent from a year ago in the third quarter 2010. It is not surprising to find in a review of the data that the reason for the drop in unit labor costs is a faster pace of worker productivity and slower rate of hourly compensation. This trend is likely to continue as the level of unemployment remains at 9 percent or higher.

The Consumer

Household net worth in the U.S. as a percent of disposable income has taken a dive in the last four years. At 472 percent of disposable income, equity is near levels posted in 1966, 1972, and 1986; a far cry from its peak of 639 percent in 2006. A significant drop in homeowner's equity and job losses can be attributed to the deterioration in household net worth. At the same time, the U.S. savings rate has risen to 5.7 percent of disposable income as of October, an indication that those with healthy balance sheets are replenishing reserves instead of spending. This is probably wise as the jobs picture is *slowly* getting brighter and home price depreciation is a long way from stabilizing.

Real disposable income has grown just 2.5 percent from a year ago followed by a 2.3 percent increase in personal consumption expenditures. Shoppers appear to have come out of hibernation, but the "shop 'til you

drop” mantra is not the pervasive sentiment as evidenced by retail sales data. October 2010 retail sales rose by 1.2 percent from the previous month, led by a 5 percent acceleration in motor vehicle and parts sales. Excluding autos, sales are higher by 0.4 percent for the month and 6 percent from a year ago. Vehicle sales occurred at the fastest rate, 12.25 million units, which is the strongest pace since the Cash-for-Clunkers program expired in August 2009. The recent increases in fuel prices also boosted the data, which records sales in dollars. October sales were the highest since the beginning of this year and exceeded most economic forecasts for the period. Preliminary holiday shopping data also show an increase from a year ago. *All sounds rosy on the surface, but a year ago comparison is misleading as one would hope conditions have improved.* In order for GDP to advance at a faster than 2.5 percent pace, consumer spending needs to embark on a sustained rate of growth above 2.5 percent over the next 12 months. With unemployment stubbornly above 9 percent, and an under employment rate at 17 percent, continued advances in consumer spending are not a foregone conclusion.

Corporate Profitability

Just as consumers have repaired balance sheets, so have U.S. corporations. As of the third quarter of this year, the Bureau of Economic Analysis reported a 2.8 percent advance in net profits of U.S. companies; putting the current annualized growth rate at 25 percent. This is the seventh consecutive quarterly gain in net profits* recorded (*includes inventory and capital adjustments). Aggressive cost cutting has overshadowed mild sales to afford wide profit margins. Rising profits have generally foretold future hiring as companies realize that earnings growth cannot be achieved by cost cutting alone. Corporations need to hire and invest in equipment and product development in order to generate sustainable revenue gains. While the U.S. business cycle is not there yet, the pieces are falling into place for a potential boost in employment a year from now. Just as profits are advancing, the cost of borrowing for non-financial corporations is also improving, resulting in record low interest coverage ratios. Credit markets continue to recover, affording more sources of funds for corporate growth. Business confidence remains tepid; however, *if monetary policy is successful at maintaining low interest rates, and tax policy continues to reward corporate hiring (e.g. payroll tax reduction is extended) U.S. corporate managers may finally have the gumption to grow and expand payrolls.*

Employment

The current pace of economic growth has not been sufficient to create enough jobs to lower the unemployment rate. Average payroll gains of 100,000 to 150,000 are barely enough to prevent the unemployment rate from rising further. According to the Bureau of Labor Statistics, there are approximately five unemployed workers for each job opening. To put this in perspective, for the period 2002 through 2005, the ratio of unemployed workers to job openings was between 2.0 and 2.8. Another issue that needs to be addressed by fiscal policy is the November expiration of the provision that extends unemployment benefits for those that have been out of work for up to 99 weeks. The failure to extend the benefits to more than 1 million unemployed people as we head in to the Christmas holiday will surely be a blow to consumer confidence in addition to personal income. The Democrats may use this as a bargaining tool whereby the Republicans get an extension of tax cuts for those making more than \$250,000 per year in exchange for the extension of unemployment benefits.

The Achilles Heel

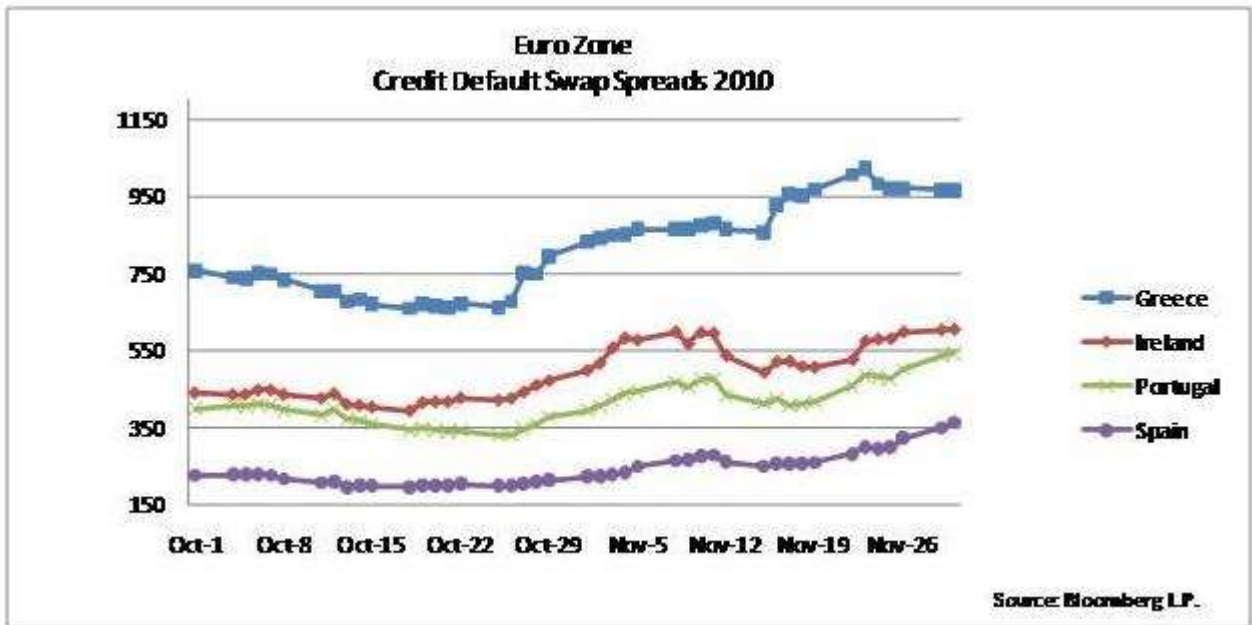
October housing starts fell 11.5 percent, another indicator that the housing market may be reversing its improving trend. This is the second monthly decline in new home construction as builders remain cautious with regard to future demand. Multi-family housing seems to be suffering the greatest decline, with starts down 43 percent from September to October after a building spurt this summer. Permit applications in the past month also suggest a further pullback in construction.

Existing home sales, which now comprise 90 percent of all home sales, were down 2.2 percent in October to an annualized 4.43 million units. Sales are down in all regions of the country and are 25.9 percent lower than a year ago. The temporary foreclosure moratorium shined a light on the importance of distressed sales, as the supply of homes rose from 7.9 months in September to 8.6 months in October. We expect the inventory of unsold homes to grow as lenders review foreclosure processes in response to regulatory inquiries. Unfortunately, that foretells a longer period of depressed home prices.

On the issue of home prices, the median price for an existing home is \$170,500, down 1 percent year-to-date as of October. The Case-Shiller home price indices weakened the past three months, with the 20-city and 10-city indices falling to -0.8 percent and -0.7 percent respectively from August to September 2010. On a year-over-year basis, the indices are down significantly from the peak levels recorded in May; however, prices are up slightly at 0.5 percent for the 20-city and 1.5 percent for the 10-city index. A combination of the expiration of government incentive programs, increasing distressed sales and persistently high unemployment act as an anchor for current home prices.

Euro Infection

Yes, Ireland finally succumbed to European Union (EU) and International Monetary Fund (IMF) pressure for a lifeline for its ailing banks and budget deficit. The \$115 billion aid package included funds from the IMF, a Euro rescue fund and direct aid from other European and UK central banks. The market appears to have priced in the Irish rescue, but lurking in the background are similar issues in Portugal and Spain, both of which have huge debt obligations coming due in the next year. Spain is the bigger worry for policy makers because it accounts for approximately 10 percent of the euro zone economy, in contrast to Greece, Ireland and Portugal, which account for less than 2 percent each. Like Ireland, Spain's primary deficit, the gap between what the government spends and collects in taxes, is at an alarming 10 percent of GDP. This deficit excludes the interest payments due on the country's debt. As a result, these countries are very dependent on the financial markets to fund operations and pay down debt. Unfortunately, Spain's borrowing costs have soared as evidenced by recent sales of 3- and 6-month bills, which the government curtailed due to the high rates demanded by fearful investors. Significant budget cuts are the minimal action necessary to allow the government to meet debt obligations. Credit default swap spreads suggest difficult funding conditions for Spain and Portugal will persist into the new year.



Portugal is considered a risk because of its meager economic growth and its high debt levels. The government must begin refinancing billions of Euros in government bonds early next year, and is likely to ask for aid to meet these obligations. Portugal has borrowed huge amounts to finance long standing welfare entitlements and private spending, while protecting jobs through outdated labor laws that ignored changes in market conditions.

Greece is scheduled to receive the second round of its \$150 billion bailout package, with many foreign officials

concerned that it is not enough to finance the countries bulging deficit. Government reforms addressing deficit targets and funded programs are sorely needed in order for Greece to even consider standing on its own two feet.

Several economists and academics suggest a default by Greece and other indebted countries may be a solution, as European finance ministers have hinted that investors/lenders should share in the cost of resolving the debt crises. Unfortunately, the Euro region is so entwined a default could lead to a systemic disaster. Greece, Ireland, Spain and Portugal combined have roughly 2 trillion in sovereign debt held by banks in Germany, France, U.K. and local banks and pension funds in Greece.

Conclusion

Our outlook for interest rates has been truly tested in October and November as the equity markets rallied and bond yields rose in response to the mid-term elections in the U.S., news of the second part of the Fed's quantitative easing program and fears of rising inflation. All aforementioned actions are *expected* to lift economic growth as political "gridlock" is assumed to be better than uncertainty, and lower rates induced by Fed purchases of Treasury securities will promote business spending and provide a foundation for economic growth. We remain skeptical that the U.S. economy is about to embark on a sustainable recovery. After all, the Fed appears to share the same belief, otherwise why would they invest another \$600 billion on top of the outstanding \$2.1 trillion in their current portfolio? Gridlock may not be such a good thing as the market rally also assumes the Bush tax cuts will be extended at the end of the year---will they? If not, what kind of damage will a tax increase do to consumption and investment in an economic environment where savings is now a fashionable investment strategy? In our opinion, domestic and international fiscal and monetary policies have a greater influence on the direction of future interest rates. This dependency is expected to make for a choppy bond market but, assuming policies remain stimulative, Treasury yields may be lower than the 2.80 percent current yield on the 10-year note by the first quarter 2011. Subsequent to the expiration of QE2 in the spring of 2011, rates are likely to move sideways to slightly higher as optimism overtakes government policy as the driving force behind rate movements.

Stern Agee is one of the larger full service brokerage firms headquartered in Birmingham, AL. Please contact [Sharon Stark](#) for more information.

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That's Right! Why a Rights Offering could be a Capital Idea

by Becky Pendleton Reid and Kevin McAuliffe

Capital is King in today's market, and almost every banker in the country is either completing a capital raise or contemplating one. Whether the proceeds are to bolster a weak balance sheet, provide a fortress to withstand further credit quality issues, to pay off government TARP investments or to create a funding source for expansion or acquisition, the ability to raise new capital is the sign of not just a survivor, but also a winner in today's banking environment. Year-to-date, more than \$35 billion of fresh equity capital has been injected into the international banking system. Sources of capital and deal structures may differ, but the importance of strong capital has never been higher.

Whether the capital comes from a private placement or an underwritten public offering, a rights offering to existing shareholders can be an important part of a bank's capital strategy. There are three reasons to consider a rights offering, either stand alone or in conjunction with other capital raising strategies:

- Loyalty -- Your existing shareholders have been through a tough ride and those that have stuck with the bank should be given the opportunity to maintain, or increase their positions.

- Fairness -- If outside investors have negotiated favorable terms, then existing shareholders should be given the opportunity to invest alongside these newcomers at the same price and same terms. If dilution is a result of the capital raise, existing shareholders should be given the opportunity to maintain their relative ownership.
- Efficiency -- Raising Capital is a time consuming and intensive process. Leverage the documents you have produced (10K, 10Q or S-1), which include much of the information used in a rights offering.

A rights offering that is not part of a broader capital raising effort does not require stockholder approval under either NASDAQ or New York Stock Exchange rules. The mere announcement of a rights offering may create interest in a company's stock from non-stockholders who wish to take advantage of the favorable terms of the rights offering, and buy shares before the record date for the rights offering. A rights offering, that is part of a broader capital raising effort, enables existing stockholders to maintain their ownership percentage in a company despite the influx of new capital.

Exactly What Is a Rights Offering?

A company issues rights to its existing stockholders to buy new shares based on current ownership holdings of the company's stock, typically at a discount to the market price (primary right), at a future declared date. Rights offerings are for a limited period of time and can allow for "over subscription", which means that those who want to purchase more shares than they own can buy those rights to shares that are not exercised by their owners (secondary right).

A rights offering can be structured as a stand-alone transaction, or as part of a broader plan to raise capital. Rights offerings can either be a direct offering, if the price discount is sufficient to attract interest and the company is well-established. In a direct offering the bank will have the capacity to complete the offering on its own.

Alternatively, a rights offering can be conducted with the assistance of an underwriter, either with a firm commitment or a best efforts basis. In a firm commitment, the underwriter agrees to purchase all the shares offered that the stockholders do not purchase (at the subscription price).

In assuming this "standby" risk, the underwriter receives a commission on all shares covered by the rights offering.

Rights can be transferable or non-transferable. Transferable rights would trade on a stock market during the exercise period. The trading price is up to the market. If the price of the underlying common stock rises during the rights period, the price of the rights might rise as well.

Non-transferable rights are not tradable or traded and have no value other than that they may be exercised by the original holder in the rights offering.

Insuring Success for Your Rights Offering

While a rights offering can be a viable option to increase capital, it must be properly structured, attractively priced and based on a solid foundation of safety and soundness. If a bank is not very well capitalized, a rights offering may not be able to be completed unless it is completed in conjunction with a solid infusion of new capital from outside funding sources. That vote of confidence from new investors is important.

And there is no better way to signal confidence than for insiders to step up and fully subscribe to the rights offered for their ownership position. In addition, before starting a rights offering, bankers should speak with their largest shareholders to insure they will support and subscribe to the offering. Structure is also important to institutional buyers, and by surveying your largest owners early, you can insure that your terms and structure meet their needs.

Many board members may be concerned about offering stock at a discount to book value, below the current

trading price, or at other valuation measures that are below the perceived value of the company. Dilution of earnings or book value is an important consideration when raising capital, but if these new funds can be deployed to raise the earnings capacity of the franchise, provide funding for organic growth or acquisition and make long-term financial sense, then the dilution numbers themselves are less important than the possibilities they create.

If the ins and outs of a rights offering seem complex, the benefits are pretty simple. A rights offering, particularly when done in conjunction with a supplemental capital raise, demonstrates the company's appreciation and commitment to its long-term loyal owners. Giving your existing shareholders, many of whom are customers as well, the opportunity to participate at the same discount price and same terms as new investors sends a powerful message of reciprocity for loyalty. While a rights offering alone, may not be able to raise enough capital to meet the current needs of the institution, they offer a cost effective way to increase capital and reward loyal owners.

Rights offerings can provide capital immediately and pay dividends for many years to come.

Steps Required to Complete a Rights Offering

Following board approval, the company announces its intention to commence the rights offering. The company must file a registration statement with the Securities and Exchange Commission with respect to the securities being offered and sold. The shares to be sold (and the rights to be issued, if transferable) must be listed for trading on the applicable stock market.

Due diligence is conducted by company counsel, and if applicable, the investment banker and any outside individuals/entities who are buying shares as "standby" purchasers.

The company negotiates the terms on which outside individuals/entities will make their investment.

The period of time during which the shares are offered typically is 20 or 30 days.

A rights offering can be completed in as little as six to eight weeks from board approval, or it could take up to four to six months to complete.

A Short-form registration statement is available for an offering made only to existing stockholders.

Please contact [Becky Pendleton Reid](#) for more information.

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Is Social Media Worth the Investment?

by John Marsh and Andy Mus



One of the hottest marketing trends in banking, as it is in most other industries, is social media. The hype surrounding Facebook, Twitter and the like has many companies worried that if they don't get on board, they will be left behind. Is this really so?

Not if you look at banks that have taken the plunge by simply setting up a Facebook page, a Twitter account and a blog – without any real strategy behind it. There's not much to show for their efforts because for them, social media is a solution in search of a problem. It may get some people to "like" you or "friend" you, but there isn't much profit in it.

To reap tangible benefits from social media, start by identifying the challenges facing your bank, and then look to social media as part of your overall marketing strategy. In our experience, social media can best help address the following problems experienced by many banks:

- How to attract new customers, especially younger customers, who are less inclined to walk into a bank branch (as banks experience natural attrition of older customers).
- How to attract customers and deposits from outside your bank's immediate geographic market.
- How to grow your bank without relying on real estate loans and brokered deposits.
- How to protect your bank's brand and better communicate with customers, shareholders and local communities in the wake of the Dodd-Frank Act and financial industry turmoil.
- How to differentiate your bank's brand from other banks that offer similar marketing, products and services.
- How your bank can become more deeply involved in your community on a consistent basis.

The prime benefits of social media for banks are attracting qualified prospects that you previously did not have access to, and offering new ways to solidify and grow customer relationships. For example, there are opportunities to use social media to conduct customer research for developing new banking products and services tailored for post-college prospects.

To reap these benefits, social media programs must be based on a carefully planned, targeted strategy, supported by specific metrics by which banks can measure the success of the program and adjust the strategy as needed.

Strategy

As with any new product introduction, start by determining what the bank wants to accomplish – who you want to target, what the costs are (both time and capital) and what is expected in terms of return on the investment. Doing so will enable you to make smart choices as to the particular mix of ever-expanding social media platforms through which to market the bank.

To help determine your objectives, listen to what is being said online about the bank and its peers. Set up Google Alerts to notify you whenever your bank is mentioned on the Internet, including on blogs, Facebook and Twitter. Find out which customers are active online, what they talk about, what concerns they have. This will tell you where and how the bank can best address customer concerns and issues. One of the most important keys to the success – OR failure – of a social media strategy is the ability to deliver compelling content consistently over time. You not only want to initially engage your targeted audience, you want to give them a reason for continuing to follow your bank.

One of the most important keys to the success - OR failure - of a social media strategy is the ability to deliver compelling content consistently over time. You not only want to initially engage your targeted audience, you want to give them a reason for continuing to follow your bank.

The best sources of compelling content are likely to be a bank's staff, culture and the local communities in which it operates. Social media messaging should reflect the bank's personality, fostering a two-way relationship with readers, providing them with information they can use in an interesting way, which will indirectly promote the bank's products and services along the way.

Once your social media effort is ready to go, it is vital to draw attention to it. This isn't an if-you-build-it-they-will-come scenario. Start by promoting your social media presence through your other marketing and community efforts. Publicize your Facebook and Twitter addresses just as you do your website address in your advertising, on direct mail pieces, business cards, email signature lines, etc.

Many companies utilize contests as a way to draw people's attention to their social media program. JPMorgan generated a lot of attention by donating \$5 million to charities that received the most votes from followers on its

Facebook site. A credit union held a contest where contestants wrote a blog on behalf of the institution, with the prize being the job of official blogger for the credit union. It was a free and easy way to recruit and vet candidates for a new, specialized position, and garnered a great deal of exposure for the credit union in the process.

Metrics

Tracking the ongoing performance of a social media campaign is vital to its success. As with any marketing campaign, you need to develop a benchmark against which you can measure results, and you need quantifiable metrics.

The good news is there are many available tools (too many to list here) that banks can use to measure performance of a social media program, including traffic statistics, ratio of positive/negative comments about the bank, how people are sharing the bank's website, etc. The most common is Google Analytics, which enables users to track traffic levels to determine increases or decreases in traffic, identify where that traffic is coming from, e.g. a website or blog, Twitter, etc., and which keywords or phrases garner the most interest.

Pick and choose the specific tools that match the media platforms and goals of the program or campaign, so that you limit the data to what is most important. Prior to starting a social media campaign, track the appropriate metrics to determine a baseline. Then, once the campaign is underway, you can measure any change in results.

Costs

The hard costs of starting and maintaining a social media campaign are negligible, as most outlets are free. The most important factor to consider is the cost of time to properly operate an ongoing social media program. A truly successful effort requires a considerable employee commitment, as it requires regular updating of information.

Some experts estimate that it takes at least 5-10 hours to write 2-3 blog articles each week, another 5 hours per week for Twitter and Facebook, and untold other hours to develop and integrate video into social media initiatives. And let's not forget monitoring and ongoing adjustment of the program.

Given the fact that many banks have reduced overhead to a minimum in the past several years, giving more work to fewer people, simply assigning the additional workload to an already stretched marketing staff may not be the best course of action. Many banks will need to outsource the work to someone outside the bank, or hire a full-time staff member to ensure a well-run, successful social media program.

Compliance

Probably the thorniest social media issue for banks is compliance. Social media falls under the same rules as print, radio and television advertising. As such, bank compliance officers need to have a say in the planning and ongoing operation of a social media program.

The *ABA Banking Journal* has published compliance tips regarding social media including conducting a compliance risk assessment, establishing policies and procedures in writing, establishing controls to help address the risk identified in the compliance risk assessment, and setting up a monitoring process.

In addition to these steps, bank management also needs to set clear guidelines for employee involvement in social media outside of the workplace, where staff members have the ability to say anything (good or bad) about the bank, fellow employees and customers. Having an ongoing social media program actually will help turn the employees into advocates and provide an effective way to manage their social media involvement as it regards the bank, reducing the risk of liability.

The bottom line is that social media is not going to make or break the success of your bank, but a well-structured, targeted campaign can be an effective new weapon in your marketing arsenal.

John Marsh is President and Andy Mus is Senior Vice President of Marsh Communications LLC, a financial services investor relations and PR firm based in Atlanta that works with numerous community banks across the country. For more information, visit www.marshcomm.net.

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OCI "Changes" Not So Bad

by Mike Gullette, Vice President, Accounting & Financial Management, ABA

Related to their exposure draft (ED) on financial instruments, FASB simultaneously issued an ED to require that one statement of comprehensive income be presented, eliminating the option to present a separate income statement and statement of comprehensive income. Many companies, banks included, oppose this idea, as it creates a new bottom line and emphasizes fair value changes of available-for-sale securities that are recorded through Other Comprehensive Income (OCI). With the financial instruments proposal to require changes in loan fair values to be recorded in OCI, the problem magnifies exponentially.

During their joint meeting with the IASB, however, FASB appears to have put off any major changes for now. Rejecting the staff recommendation to present one statement, FASB and IASB will maintain the option to present a statement of comprehensive income separate from the statement of income. The statements must be presented consecutively and be titled "Statement of Profit and Loss" and "Statement of Other Comprehensive Income".

Other than some other relatively minor adjustments, that's about it. This is good news, as it allows banks to keep investors focused on the true bottom line.

These new requirements, as small as they are for most companies, will be effective for fiscal years starting after November 15, 2011.

For more information, contact ABA's [Mike Gullette](#).

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What Should You Know About Shareholder Activism?

by Diane Fitzgibbons, Managing Director, The Cereghino Group



Activist investors are once again gearing up for this year's proxy voting season. With the changes in proxy voting rules and the increase in shareholder proposals, corporate boards should have a plan of action if an activist starts calling. Companies will be dealing with shareholder activists now more than ever, and should prepare in advance for their shareholder meetings in 2011.

An activist investor is a shareholder, or group of shareholders, in a publicly-traded company who primarily seeks to make changes in management or operations in a way that suits their own interests. Activist investors often deliberately acquire substantial stakes in certain companies and therefore wield enough influence that the company often must listen to them. Activist investors may choose to negotiate directly with the company or indirectly through methods like proxy contests, consent actions or public shaming. Activist investors can vary and may be investment companies, institutional investors, shareholder groups, or even wealthy individual

shareholders.

There are two types of activist investors: those seeking to unlock value for company's perceived to be underperforming and those seeking to address socially responsible issues. Regardless of the type of activism, a proxy contest can be expensive, time consuming and too often generates negative sentiment with customers, employees and shareholders. "The best defense against an activist is a strong offense," said Leonard Cereghino, President of The Cereghino Group, a corporate investor relations firm. "Your shareholders are more likely to support corporate boards long term strategies if they understand your goals, and are continuously kept abreast of developments within the company."

Value Activist

Value activist investors usually seek to acquire one or more board seats in order to effect change in policy, force an asset sale or whole company merger. Value activists are seeking to maximize their own return on investment.

Most institutional shareholders are not activist investors. They want to find great companies with superior managers in which to invest. If they feel like the business dynamics do not meet their investment criteria, they are far more likely to sell their position than to launch a proxy contest. In essence they usually prefer to vote with their feet and walk away. If, however, they feel an orderly exit is not possible, due to the size of their position, the liquidity of the shares, or other impediments, they may choose to engage management in dialogue. Large institutional investors, like CALPERS and other state pension funds, have grown so large in the past few decades, that they cannot exit the markets nor divest of core positions. As a result they are far more likely to engage in dialogue about governance, management accountability and social issues.

Institutional investors are also human beings and can become activists if angered by management or by board actions, particularly if they are perceived as self-dealing. We've seen many angry shareholders in recent years in reaction to the highly publicized actions of a few bad executives.

Some investors who are known for their activism are often able to create value when their ownership position is disclosed either through a 13F filing (required for mutual fund managers) or a 13G filing (any qualified investor who exceeds 5% ownership). We have seen several situations where the disclosure alone is enough to attract other investors into the company and boost share prices. In that case, the activist tends to take profits and move on to the next company.

Socially Responsible Activists

The other form of shareholder activism is the socially responsible movement that seeks not only long-term financial returns, but also seeks to influence corporate policy for social, religious or cultural issues. Some of the most well-known socially responsible investment groups are Calvert, Ariel and PAX funds, which pioneered the socially responsible mutual fund industry. Calvert fund's lists the initiatives they have placed on ballots and their results at www.calvert.com/sri-resolutions. In addition, there are numerous faith based investors that use the proxy ballot to advance their causes. For a list of resolutions filed by the InterFaith Center for Corporate Responsibility visit www.iccr.org. In addition, labor unions have been very active in executive compensation issues and worker equity movements.

Over the years many social changes have been driven by activist investors pressuring companies to address social problems through corporate activity. Apartheid in South Africa, child labor reform and environmental stewardship have all been topics for proxy resolutions by these groups. Today, executive compensation remains one of the top issues and social activists were instrumental in influencing the new legislation that mandates "Say-on-Pay" voting on this year's proxy ballots for all public companies.

Activists have several tactics they may use. The current topics that are showing up on activists "to do" lists include board diversity, risk oversight, environmental practices, social policy and political accountability. However, executive compensation will remain the defining corporate governance issue at most companies. In addition to say-on-pay proposals shareholders will also be voting on the frequency of these votes, which are no

longer routine and thus have no broker directed votes. While these votes are strictly advisory, they need to be taken seriously by boards. In 2010, when all TARP recipients had say-on-pay proposals on their ballots, only one bank's pay package received a no vote from its investors, and that was because executive salaries jumped by huge percentages. Say-on-pay will compel boards to articulate a convincing rationale for controversial practices such as tax gross-ups, high bonus payments and severance packages.

Rules to Live by:

In this day and age, a company's management team must know their shareholder base and actively engage in constructive dialogue with all its shareholders. So we offer these five rules to live by to reduce the potential for a proxy fight and if one should materialize to be in the best position to meet that challenge.

Know Thy Shareholder:

There are lots of tools available to monitor your institutional shareholder base from expensive stock watch services to a 13F data base. You should review your institutional ownership base at least every quarter and reach out to new owners when they initiate positions. Likewise, maintaining dialog with institutions through conference calls, non-deal roadshows and attending conferences is the nuts and bolts of a good investor relations program.

To NOBO or Not?:

Reaching out to your Individual Shareholders can be crucial in a proxy fight, and purchasing a NOBO (Non-Objecting Beneficial Owners) list from Broadridge allows you to see the names and addresses of most of your retail shareholders. The risk of having a NOBO list is that if you are targeted by a hostile party, they can demand to receive a copy of the NOBO list, and you have to give it to them if their request is properly executed. Usually about 40 – 60% of retail name shareholders appear on a NOBO lists, and it is one of the tools a proxy solicitor will use to help get in your retail votes. "With the changes in voting protocols and the elimination of the broker directed vote, we are seeing just how low actual retail voting has become," said Karen Smith, President of Advantage Proxy. "The first time a company contacts a retail investor should not be when it is fighting an activist. Management should actively conduct a dialogue with its investors, retail and institutional alike."

Choose Your Battles:

Sometimes the best thing to defuse the situation is to talk with the activists about their concerns. If you really don't object to the request, then don't fight the request. Too many times, management objects more to the proposal than the objective. Just because the request comes from an outside party is not reason enough to object. No executive wants to be told how to run its business, but sometimes the requests are easily fulfilled. It's best to pick your battles and not let ego get in the way. And, if you let the activist feel like you've listened to their ideas, you can bring that to the table when they request something that you don't agree with.

Know the Guidelines:

The professional proxy voting advisors, primarily Risk Metrics (formerly Institutional Shareholder Services) Glass Lewis and Proxy Governance, have enormous influence on voting proxies for their institutional clients. They focus extensively on the information disclosed in your proxy and have standards and guidelines that they apply on advising how institutions vote each year. If you or your directors are not aware of these recommendations, you may risk a negative vote from these very powerful groups. For instances, Risk Metrics requires directors to have at least 75% attendance at board and committee meetings to gain their votes. But they also have reasonable exceptions for family emergencies, illness or other extraordinary circumstances—provided they are properly documented and publicly disclosed. Risk Metrics is also recommending annual votes on executive say-on-pay and has very specific recommendations on pay practices.

To review these firms, visit their websites at: www.proxygovernance.com and www.glasslewis.com and www.riskmetrics.com/knowledge/proxy_season_2010. I would be happy to provide a copy of the Risk Metrics and Glass Lewis voting guidelines on request at dianef@stockvalues.com.

Make it Easy for Retail Shareholders to Stay Connected:

Most companies have a mechanism on their website for opting into an email distribution for company news. Including a card in your annual report mailing for email or regular mail distribution for news is an easy way to reach out to investors who may not like electronic distribution. (Those folks are still out there!) The extremely low retail votes for companies that used notice and access or electronic delivery of annual reports last year demonstrates that there are still investors who respond to the actual documents. With the elimination of brokers voting for shareholders who do not return proxies on most items, especially for elections of directors, it is especially important to engage your retail investors. For firms with a sizable number of retail investors, hiring a proxy solicitor to bring in your vote may make the difference between achieving your quorum and postponing your meeting.

The Silver Lining

The 2011 annual meeting season is predicted to have some relatively good news for companies. According to IRGR Magazine, 2010, longstanding objections to proxy advisory firms, check-the-box governance analytics and formulaic share voting are no longer being ignored. Regulators, governance professionals and shareholder organizations are beginning to pay attention to two important goals long sought after by the corporate community: (1) establishing clear standards of conduct and accountability for institutional investors, and (2) increasing the transparency of share ownership and voting practices. In the wake of the financial meltdown, it is clear that higher standards of governance and deeper levels of transparency for corporations should be matched by comparable standards for institutional investors and proxy advisory firms as well.

Corporate boards need to take charge of corporate governance, improve communications and manage shareholder relations. Develop techniques and opportunities for the board to communicate with shareholders, and increase the board's access to information and resources; conduct annual review and corporate governance and compensation policies; conduct an annual board evaluation and finally, engage with shareholders on environmental practices, social policy, risk oversights and corporate governance.

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