

WISCONSIN BANKS, WISCONSIN STRONG

By Amber Seitz

On June 8, 2016, **Cynthia Erdman**, president of Partnership Bank, Tomah, was installed as Chair of the Wisconsin Bankers Association for 2016-2017. In addition to being the first woman to lead the association, Erdman will guide WBA through its 125th year of service to the state's banking industry; March 24, 2017 marks this milestone anniversary

Your association's priorities for 2016-2017

2016-2017 WBA Chair **Cynthia Erdman** and her husband **Rick**.

of WBA's founding. Speaking to WBA staff and her fellow board members at the Board Installation on June 8, Erdman stressed the importance



of looking forward while the association celebrates its shared

history with Wisconsin's banking industry. "It's important to reflect

on this tremendous milestone and all the accomplishments made by the association and its members over the years," she said. "But it is equally important for us to think about what we need to accomplish over the next 125 years."

For the first year of that next stage, Erdman has set the goal of fostering a more positive image of banking. "I want the association

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What if Your Employees Owned the Bank?

A crowdsourced succession solution

By Amber Seitz

Ownership succession

is a critical concern for closely held financial

institutions. As majority shareholders age and start to look for liquidity from their investment, bank management can find themselves facing a sale if there is no obvious successor. An Employee Stock Ownership Plan (ESOP) is a lesser-used solution that may work well at some banks. An ESOP is a federally regulated retirement plan that



invests in the stock of an employer on behalf of its employees. When the employees leave or retire, they either sell their stock on the market or back to the company. As such, ESOPs are often thought of as simply a tax-advantaged employee benefit. While true, they can also be a powerful piece in a bank's ownership succession plan.

Nationally, nearly 800 banks offer ESOPs, but most control relatively small blocks of stock. Very few bank ESOPs own more than a quarter of their institutions, though there is a tiny fraction with 100 percent employee ownership. In order to determine if this strategy is a good fit for your institution, you must first understand why forming an ESOP

can be beneficial and the process for implementing one.

Reasons to form an ESOP

Companies choose to form ESOPs for a variety of reasons, but the four most common motivations are to supplement an existing employee benefit plan, to promote growth, to create shareholder liquidity, and/or for its tax advantages. "The benefit is if you sell 100 percent of the company to an S-corp ESOP, you pay no federal and state income tax post-closing," explained **Kevin Hanson**, director at Business Transition Advisors, a consulting firm that specializes in succession planning at closely held businesses. BTA consults with ESOPs

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ESOPs

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frequently because ownership succession is another very common motivation for forming an ESOP. Nearly two-thirds of ESOPs nationally were created to provide a market for the shares of a departing owner of a profitable, closely held company. "It's sort of a 'have your cake and eat it, too' situation with ESOPs and staying independent," said Horicon Bank President **Fred Schwertfeger**.

Promoting growth is another common reason for implementing an ESOP. "Studies have shown that there is improved performance when you compare whole or partial ESOPs to non-ESOPs," said Community First Bank President **Dan Klahn**. ESOPs can also increase employee engagement and retention when staff are educated on the benefits

➤ Profitability is key. This isn't something you can do if the company is struggling financially.

– Kevin Hanson, director
Business Transition Advisors

they're receiving. "It helps us attract and retain talent," said Horicon Bank Executive Vice President **Jay Vanden Boogart**. "When they have meaningful skin in the game through the ESOP, they value that." That value is enhanced when the ESOP is added on to an existing benefit structure. Over half of ESOP companies nationally have at least one additional employee retirement plan. For example, the ESOP at Community First Bank, Boscobel is set up as a complement to their 401k plan. "From the employees' perspective, it's another added benefit," said HR Officer **Tammy Nelson**.

How to set up an ESOP

The process of implementing an ESOP is a complex one with many variations depending on the specific institution. However, every company – banks and non-banks – must start with being profitable enough to support the debt service of the ESOP. "Profitability is key," Hanson explained. "This isn't something you can do if the company is struggling financially."

Scott Huedepohl, president/CEO of Community State Bank, Union Grove, advises starting out with a thorough understanding of what the bank will need in order to support the ESOP from an administrative side, as well. "It's critical to turn over every rock and make sure you really know what you're getting into," he said. "Make sure you have the support structure in place because

you're moving from multiple ownership to employee ownership. The trustee will carry a lot of power and a lot of liability risk."

After verifying the institution's financial capability and conducting research, bank management's next step should be to hire outside assistance. "Find a firm that can help with the ESOP implementation," Hanson recommended.

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– Fred Schwertfeger, president
Horicon State Bank

That firm can help the bank conduct a preliminary analysis, which will look at the bank's ownership structure, number of employees, and most importantly the value of the

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ESOPs

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company. “If you don’t have the value, an ESOP can’t happen,” Hanson stressed. The bank’s ownership structure will also impact its ability to take full advantage of the ESOP’s tax treatment. “Having an S-Corp in place is helpful,” said Schwertfeger. “Getting your structure to the right place is important.”

If bank management determines that an ESOP is still a good fit for all stakeholders, the next step is an in-depth feasibility study. “The feasibility study defines what the structure of the end company will look like from an ESOP trust perspective, a corporate perspective, et cetera,” Hanson explained. It will also define the timing and cost of the ESOP implementation. The results of the feasibility study create the groundwork for the purchase price negotiations

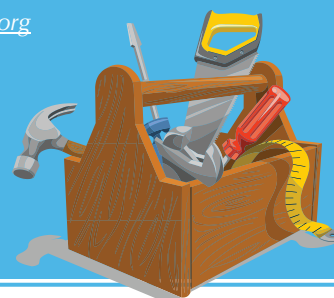
➤ It can be quite complex for the employees to understand, so we focus on education so they understand all the components.

– Tammy Nelson, HR officer
Community First Bank
Boscobel

for the transaction. Once the transaction is finalized, the ESOP must be implemented and rolled out to the bank’s employees. “It can be quite complex for the employees to understand, so we focus on education so they understand all the components,” said Nelson. “We’ve also created an Employee Ownership Council who serve as ESOP ambassadors to other staff.” This council has members from each of Community First Bank’s five branches, with positions ranging from CSR to the manager of the mortgage banking group.

Questions about forming or administering an ESOP? The experts interviewed for this article recommended these resources:

- > National Center for Employee Ownership (NCEO) – www.nceo.org
- > ESOP Association – www.esopassociation.org
- > Subchapter S Bank Association – www.subsbanks.org
- > Wisconsin ESOP Association – www.wiesop.org
- > Other banks with ESOPs
- > Third-party consultants, including tax advisors, legal counsel and speciality advisors



Is it right for your bank?

ESOPs look different at different companies, depending on their intended purpose, maturity and a host of other factors. When deliberating whether to form an ESOP, management must determine early on if this strategy fits well with the bank’s overarching strategic plan. For example, the average Wisconsin ESOP has been in place for 19 years, and many have been around for much longer. This longevity requires that bank management be forward-thinking and anticipate potential challenges that may arise for their successors. “Where your ESOP is at in the maturity cycle will impact the kind of challenges you have,” Huedepohl explained. “There’s a huge difference between an ESOP that’s mature and one that’s new.” Schwertfeger advised the same prudence: “Consider the long-term nature of the decision,” he said. A related question to consider is the bank’s ability to weather potential cash liquidity issues. Community State Bank’s ESOP is 30 years old, and with that maturity comes the challenge of ensuring that all departing employees’ shares can be bought back. “One of our major challenges is managing our liquidity,” Huedepohl explained. “We’re privately traded, so we have to make sure we have plenty of liquidity to buy those shares back.”

Another consideration is if the bank has the expertise and time to administer the ESOP in-house, or if they will need to hire a third party. “It’s fairly complex and highly regulated from an administration standpoint,” Klahn cautioned. “With that complexity and regulation comes higher cost.” However, some of that cost is offset via the ESOP’s tax advantages. Management must also

weigh the intangible benefits, in addition to crunching the numbers. For example, Community First Bank’s ESOP is just over two years old, but Nelson says she’s already seen a change in employee culture. “We’ve seen higher employee engagement over the past year or so,” said Nelson. The ESOP has also helped as a recruitment

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ESOPs

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It's consistent with the community bank culture and mindset.

– Scott Huedepohl
president/CEO
Community State Bank
Union Grove

and marketing tool. “Our community understands that the bank staff who help them every day are employee-owners, and they view that very positively,” said Klahn.

Ultimately, the most important element for management to consider when examining the idea of forming an ESOP is whether their primary motivation for doing so fits within the bank's strategy and culture. “The motivation behind it will impact the structure of the ESOP,” Klahn explained. The bank's shareholder base is the crux of both structure and motivation; to form an ESOP bank management must have an accurate assessment of shareholder needs. “You need to have shareholders who are interested in liquidity,” Schwertfeger said. For some shareholders the ESOP's tax treatment may be the most lucrative option for the sale

of their stock. “Shares sold to an ESOP can qualify for a capital gains deferral, which may save shareholders significant amounts of money as they exit their ownership of the bank,” Nelson explained. No matter what the ESOP's purpose is, the concept of employee ownership suits the community banking model. “It's consistent with the community bank culture and mindset,” Huedepohl said.

Seitz is WBA operations manager – senior writer.

Wisconsin Banks Recognized as Top Places to Work for by MJS

Each year, the *Milwaukee Journal Sentinel* compiles a list of the Top Places to Work for in Southeastern Wisconsin, based on employee surveys. Congratulations to the following six banks that were recognized on this year's list:

- » Citizens Bank, Mukwonago
- » First Bank Financial Centre, Oconomowoc
- » Horicon Bank
- » North Shore Bank, Brookfield
- » Port Washington State Bank
- » WaterStone Bank, Wauwatosa

Well done! View the full list of Top Workplaces at www.jsonline.com/business/2016-top-workplaces-375568411.html.

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