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The Changing Landscape of Activism: A Conversation with Alliance Advisors

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As part of the meeting held by the Jones Walker Banking & Financial Services Industry Team last week in Washington, DC, Jim Miller and Tom Cronin of Alliance Advisors presented current trends in shareholder activism. Following the meeting, Tom Walker, a partner in the firm's Jackson office, had a chance to sit down with Tom and Jim to delve a little more deeply into the concerns highlighted during the meeting. What follows is a recap of their conversation.

Tell us a little bit about Alliance Advisors, what you do there, and your experience with shareholder activism, particularly concerning community banks.

TOM: Alliance Advisors is an award-winning proxy solicitation and corporate governance advisory firm that provides corporations with data-backed strategies, research, and advice for dealing with dissident shareholder situations. In addition to proxy solicitation and governance advisory services, our firm also provides investor intelligence and proxy logistics services to clients. I was brought in by the firm in December primarily to deal with community banks and banking industry clients as a whole. I have worked for 40 years in the proxy solicitation business as a relationship manager helping clients identify activists and their cohorts and as well as the goals of activists once they are engaged in a dissident situation.

JIM: Personally, I have participated in over 100 proxy contests and at least twice that number of engagements with management and activists in my 10+ years' experience with another proxy advisory firm prior to joining the Alliance team in 2019. As far as "contested" and "contentious" are concerned, the Alliance team — in particular, Peter Casey, Tom Ball, and I — bring 50+ years' experience representing both issuers and activists in contested situations. Moreover, our activism defense playbook and activist risk assessment analysis are popular tools that help a company get its house in order. Those tools, among other things, provide a road map of the do's and don'ts to give the board the best chance to prevail in a contest and assess a company's relative vulnerability, or risk, of becoming a target of an activist. At Alliance, we tell our clients that failing to prepare for a potential activist is preparing to fail. The best time for a company to deal with an activist is before it becomes a target.

You have mentioned that, from your perspective, shareholder activism has increased recently for community banks. What do you think the cause of that is?

JIM: Activism in a community bank is typically led by only a handful of small investors. Historically, the more traditional and better capitalized activists have avoided targeting community banks due to uncertainty surrounding whether an investment in and/or engagement with a banking organization would constitute control. The prevailing belief was that the prospect of FRB [Federal Reserve Board] examination and supervision just for seeking to catalyze change at a bank was discomforting to most activists, as was the belief of the FRB's case-by-case approach to determining questions of control and apparent lack of transparency of its control determinations.

However, many contend that the FRB contemplated rule changes set forth in 2019 introduced an important level of predictability to the control analysis that could loosen things up for activists in the banking sector. They further contend that the simplified framework for analyzing control questions will introduce an element of predictability that will make activists' acquisition of stocks in bank holding companies easier.

TOM: I also think that there are fewer and fewer community banks throughout the country, and in this smaller group, there are some banks that have not performed very well and are identified by activists as possible targets in which they can acquire a major position and then make a profit by forcing a sale of the bank or its holding company. These activists also get many of their "followers" to join them in certain banks and assist them in the campaign. There also seems to be more institutional investors that are supporting dissidents as a whole.

In your experience, are there any "risk factors" that a community bank may have that will make it more likely to become a target of an activist?

JIM: Yes, when the bank's bylaws and certificate of incorporation lack governance provisions considered best practices, especially when compared with their peer banks. Typically, in addition to performance issues, activists look for weaknesses in the company's board structure/composition and shareholder rights provisions and whether the company's governance provisions align with best practices or are superior to those of its peers. That is why it is important to perform a risk assessment on a regular basis. One of the benefits of a risk assessment is its ability to uncover potential areas for improvement or "low-hanging fruit" that the board can proactively address. That way, the company can get out in front of the dissident and will not appear reactive to dissident stimulus, but rather as taking initiative. More generally, the risk factors include:

- Relative inferior performance — including problematic M&A transactions, poor shareholder returns, and unfavorable peer benchmark comparisons — as performance concerns typically carry the most weight in a contest, at least with institutional investors.
- Poor corporate governance provisions, as highlighted above.
- Environmental and social issues — in particular, human capital management issues such as lack of board diversity — which have become another concern that activists may employ to "pile on" a target.
- Executive compensation that is not aligned with performance or is a very high multiple of median performance.

That said, banks that are performing well, in both absolute and relative terms, generally do not get targeted and, if targeted, do not lose proxy contests. However, in situations where a bank is performing worse than its peers, those other risk factors become more important since they give shareholders, especially those who may be undecided, more ammunition to justify a vote for the activist.

TOM: With many of the community banks, your main issues are the lack of buybacks, lack of dividends, lack of stock owned by the board and officers, and lack of insider interests. Activists look for opportunities to push the target into a quick sale so the activists can receive a quick profit, and all of these factors are critical to that analysis. I also think all corporations should know who their shareholders are and have periodic contact with them to get to know them and their interests before they have to request a proxy card from them.

What do you think are the most effective steps a community bank can take, before an activist becomes involved, to address risk factors that may be present?

TOM: The main thing is to make sure the corporation is more proactive than reactive by protecting dividends, providing buybacks, and becoming familiar with its shareholders' interests and giving them what they are looking for before they have to approach those same shareholders to solicit proxies during a contest. Most importantly, make sure the bank is running well and has no performance problems "under the hood" that may not yet be known. Finally, it is important to develop a corporate communication policy before a problem arises so that the corporation only has one voice and there are not numerous insiders who are engaging the activists and giving separate pieces of information that may be inconsistent or even conflicting.

JIM: Community banks should regularly assess where they stand on absolute and relative bases. No company is immune to activism anymore, so it is important to identify what makes you vulnerable relative to your peers. This includes evaluating not solely the bank's financial and [total shareholder] returns, but also reviewing and changing governing documents when appropriate to address board governance provisions, executive composition alignment, and environmental and social issues. It is equally important to maintain investor dialogue, particularly on strategic plans, and present a clear, transparent, and compelling rationale for choosing that strategy.

The main steps to consider for prevention of an activist problem are the following: (i) assess your vulnerabilities; (ii) review your strategic plan; (iii) maintain open dialogue with your investors, particularly your larger ones; (iv) establish a stockholder surveillance program to identify possible activists; (v) assemble a response team; and (vi) know your response plan. Again, the optimal time to deal with an activist campaign is before the corporation becomes a target.

In your experience, how many community bank management teams are ultimately successful when engaging an activist shareholder vs. how many ultimately succumb to the demands of the activist?

TOM: Probably in one-third of the situations the activist wins, in one-third management wins, and in one-third there is some type of a settlement between the two. Obviously, it largely depends on numerous variables that affect the result (percentage of activist shareholder ownership, management resolve, etc.).

JIM: I think in the past there was more "saber rattling" than proxy contests that went to a vote within this sector. Typically, community banks were beset by activists with limited positions and resources. However, as highlighted above, the activism landscape for banks is changing and expectations are that activists no longer are as reticent to target this sector, as evidenced by the uptick in campaigns this year and the addition of larger and more credible activists.

ISS and Glass Lewis have recently announced voting guidance with respect to corporations that lack gender or racial diversity on their boards. What is the status of that guidance, and how do you expect it to be applied to next year's annual meetings in which there are board contests?

JIM: While ISS and Glass Lewis won't make the argument for the dissident, they will weigh it unfavorably against a corporation when raised by the activist. Proxy advisors' analytic frameworks and policies for contested situations are separate and distinct from those for uncontested meetings. The relative importance of that issue in a proxy fight depends on whether the dissident raises it as an issue, particularly if the company's performance relative to its peers is also unfavorable. Though it may not in itself drive the vote recommendation in the contest, it will be highlighted to let shareholders decide for themselves whether the lack of diversity merits change at the board level.

TOM: I also think it will become more important to ISS and Glass Lewis in proxy contests as time goes on and lack of diversity continues, especially when new board members are added.

The Universal Proxy Rule recently announced by the SEC is widely expected to change proxy contests with activists dramatically. How do you anticipate the rule changing proxy contests for your clients, and do you think it provides the activists or the corporation with an advantage?

JIM: We agree that it will dramatically change the dynamics of a proxy fight. There will be much more of a granular focus on the individual nominees as opposed to a focus on the different proxy cards of the contestants. We do think it could lead to more threatened contests and settlements, and as we mentioned earlier, it provides an easier pathway for activists. We also foresee many growing pains given the newness of the rule. For example, what happens when there is the rule and multiple activists?

TOM: I also think more proxy contests will be pursued since it will be easier and less costly for activists, and current activists are likely to pursue more contests than they have in the past because of this. I really think that initially, it will be a disaster of mistakes and investor confusion among all parties involved until everyone figures how this new system works and the rule is perfected following implementation.

Thank you both.

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