ARKANSAS COMMUNITY BANKER

Winter 2018

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Arkansas Disallows Pre-Dispute Jury Waivers

BY MARY TIPTON-THALHEIMER

To avoid the time, expense, and uncertainty of submitting a claim to a jury, banks commonly include provisions in their loan documents that conspicuously state the parties to the loan documents waive their right to a jury trial for any claims arising out of or related to the loan documents. The majority of courts all over the country have upheld such jury-waiver provisions.

• THE AUTHOR •

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On December 7, 2017, Arkansas adopted the minority view when the Arkansas Supreme Court (the "Court") delivered its opinion in *Tilley v. Malvern National Bank.*[2]

In July 2010, Kenneth W. Tilley and Malvern National Bank (the "Bank") entered into a loan agreement. The loan agreement included a jury-waiver provision, but when the Bank filed a foreclosure action against Mr. Tilley, he demanded a jury trial on his counterclaims against the Bank and a former bank employee. The trial court and the Arkansas Court of Appeals found that, pursuant to the jury-waiver provision, Mr. Tilley waived his right to a jury trial. The Court found otherwise.

The Court examined the counterclaims raised by Mr. Tilley and concluded that because his counterclaims were historically submitted to a jury and the sole remedy sought was monetary damages, his claims were the type that should be submitted to a jury as a legal matter. The Bank asserted that even if Mr. Tilley's counterclaims were the type that should be submitted to a jury, he waived the right to a jury trial by executing the loan agreement, which included a jury-waiver provision. Mr. Tilley asserted that, notwithstanding the jury-waiver provision in the loan agreement, the Arkansas Constitution provides that the right to a jury trial "shall remain inviolate."

While the Arkansas Constitution does state "the right of trial by jury shall remain inviolate," it also states "a jury trial may be waived by the parties in all cases in the manner prescribed by law." The Court interpreted "in the manner prescribed by law" to mean any waiver must be governed by Arkansas statutes and the Arkansas Rules of Civil Procedure. For example, as noted by the Court, arbitration agreements are enforceable because the Arkansas Arbitration Act has been codified in Arkansas Code Annotated §§ 16-108-201 *et seq*. Currently, no Arkansas statutes or rules of civil procedure expressly provide for pre-dispute waivers of the right to a jury trial. Additionally, the Arkansas Rules of Civil Procedure that do address waiver of a jury trial indicate that the waiver may only take place after a party makes a jury demand. Accordingly, a narrow majority of the Court held that contractual jury waivers are not enforceable under the Arkansas Constitution.

As a result of the Court's ruling in *Tilley v. Malvern National Bank*, banks can no longer rely on the jury-waiver provisions included in their loan documents to shield them from the possibility of a jury trial. Because a foreclosure action is an equitable action, the *Tilley* ruling does not affect a bank's right to submit its foreclosure claim to the judge instead of a jury. However, if the bank also has legal claims or the borrower has legal counterclaims against the bank in connection with the subject loan, the borrower can demand that the legal claims be submitted to a jury regardless of whether the borrower executed an agreement that includes a jury-waiver provision. Therefore, the only way for Arkansas banks to ensure claims arising out of or related to their loan documents are not submitted to a jury is to include an arbitration clause in the loan documents.

While inclusion of an arbitration clauses in loan documents is currently the only way to absolutely avoid a jury trial in Arkansas, that might not always be the case. As noted by Justice Wood in her dissenting opinion, the Arkansas General Assembly has the authority to determine how a party may waive his or her right to a jury trial. Thus, the Arkansas General Assembly could always enact a statute that explicitly states parties to a contract may waive the right to a jury trial. Additionally, for contracts with out-of-state borrowers, the loan documents could include a choice of law provision designating the other state's law as the governing law. Thus, despite the *Tilley* ruling, banks should not rush to strike jury-waiver provisions from their loan documents.

[1]Prior to December of 2017, only California and Georgia found pre-dispute jury-waiver provisions unenforceable. *See Grafton Partners L.P. v. Superior Court*, 116 P.3d 479 (Cal. 2005); *Bank South, N.A. v. Howard*, 264 Ga. 339, 444 S.E.2d 799 (1994).

[2]*Tilley v. Malvern Nat'l Bank*, 2017 Ark. 343.

[3]*Id*. at 2.

[4]*Id*. at 3.

[5]*Id*. at 4.

[6]*Id*. at 2.

[7]*Tilley*, 2017 Ark. 343, at 8.

[8]*Id*. at 9.

[9]*Id*. at 10.

[10]Ark. Const. art. 2, § 7.

[11]*Tilley*, 2017 Ark. 343, at 13—14

[12]*Id.* at 14.

[13]*Id.* at 15.

[14]*Id.* Justices Baker delivered the opinion, and Justices Wynne and Hart and Special Justice Warren joined. Chief Justice Kemp did not participate. Justices Goodson and Wood each authored a dissenting opinion, and Justice Womack joined Justice Wood's dissenting opinion.

[15]*See Tilley v. Malvern Nat'l Bank*, 2017 Ark. 343, at 7.

[16]*Id*. at 20.

How the Evolution of the Employee Benefits Industry Results in Big Wins for HR

BY DEREK OWENS

Remember the days when your health insurance broker would show up a few weeks prior to renewal to share the inevitable news that your group health rates were again going up? Options may have been presented, dental and vision coverage may have been offered, and then decisions were made for the upcoming year.

• THE AUTHOR •

Derek Owens

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Afterward, you were left to manage open enrollment, shuffle through applications and take on the next plan year. This model seemed prevalent across the country, and frankly, was a decent one given the demands of the time. This wasn't very long ago.

Then, things began to change in 2010. The changes brought about by the ACA in 2010 didn't initially do much to make the lives of HR professionals and business owners easier. In fact, it was quite the opposite. Reporting requirements, coverage mandates, new terminology, and general uncertainty were the order of the day. As the ACA unfolded, it took employers and the benefits professionals way out of their comfort zone. As employers looked to their brokers for advice on how to control costs and stay compliant, brokers were forced to evolve and adapt, or become obsolete. That's when things began to look up for HR professionals.

Brokers and advisors who chose to adapt began to develop new expertise. Many firms looked to the HR and compliance community to find subject matter experts on the ACA that would enable them to more effectively guide their clients. Naturally, these experts brought along more than just ACA knowledge. As resourceful brokers recognized this new skill set available to them, they expanded their service offering to include some HR related consulting services. Employee Handbook review, guidance on employer/employee relations, and guidance on compensation strategy are just a few examples of how benefits brokers covered new ground to enhance the value delivered to their clients.

Fast forward to today. The employee benefits community is going through major changes. Many brokers are consolidating with larger national firms through acquisition. Others are embracing the emerging opportunity by constantly seeking new tools and expertise to enhance the client experience. Innovative brokers of the past are morphing into HR consulting partners with tools like applicant tracking systems, new hire onboarding tools, and payroll and benefits administration platforms to deliver more comprehensive administrative services. While benefits will always be critically important to both employees and the bottom line, they now only represent part of the total value proposition that brokers of tomorrow will bring to HR. Next time an agent or broker approaches you to try and save a few percentage points on your health renewal, ask how else they can help contribute to your overall HR strategy.

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[i] http://www.symantec.com/content/en/us/enterprise/media/security_response/whitepapers/ISTR2016_Ransomware_and_Businesses.pdf
[ii] https://www.fbi.gov/news/stories/incidents-of-ransomware-on-the-rise
[iii] https://www.ffiec.gov/press/PDF/FFIEC%20Joint%20Statement%20Cyber%20Attacks%20Involving%20Extortion.pdf

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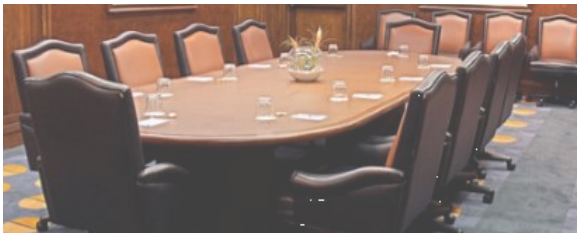

Don't Waste Time on Strategic Planning

BY PHILIP K. SMITH

THE AUTHOR.....

Philip K. Smith

President & CEO of Gerrish Smith Tuck, an ACB Associate Member

From the title, you might think this article will focus on why financial institutions should not engage in strategic planning. Quite the contrary, we think financial institutions of all sizes should be engaged in at least a yearly process of strategic planning. But the point is not to waste the time you allocate for planning by making key mistakes in the process or not structuring strategic planning in a way to be efficient and effective.

Accordingly, we have set forth some dos and don'ts below to give you a feel for how to make the most of your strategic planning. Our firm has the good fortune of facilitating scores of planning retreats all across the country each year for banks of all different sizes and there is no one size fits all approach. However, some of the common issues and mistakes we have seen organizations make are outlined below to help you navigate the process appropriately.

One of the questions that always comes up is what level of involvement either the Board or the management team should have. It might not surprise you to know we have clients who have the Board of Directors handle strategic planning entirely without the management team and then simply present the strategic plan to the management group for implementation. Other banks have the management group prepare the entire strategic plan without the Board's involvement and simply present it to the Board for ratification.

Do you want your Board involved in the strategic planning process? If the answer is no, it is possible you could have a problem. One potential problem is that you do not think your Board of Directors is cut out to handle strategic planning, they are not engaged enough to the point where they would want to be involved or you simply look at that as a management function. In those circumstances, we would suggest you probably have the wrong type of people on your Board. In addition, if your Board is unwilling to participate in the strategic planning process because, candidly, it becomes merely an operational and tactical session talking about asset liability management, cybersecurity risks and threats, the new server that was installed or how the operations people can create better flow in their workstations, then you need to change the way you are doing strategic planning so that it is engaging to the Board. We believe the Board should be involved at some level in the planning process. Maybe it is just an oversight function, but a Board or a management team attempting to set strategic direction for an organization without the input of the other is shortsighted and may ultimately prove to be a liability. Let's get all the parties on the same page.

Take a look at these ten strategic planning mistakes. Here's a list of things to avoid and a brief discussion about each.

1. Don't let the President facilitate the strategic planning session. If you are going to try to hold a comprehensive strategic planning session, really no one connected with the bank should try to lead that discussion. The fact is whether it is the Chairman, President, CFO or some other person connected with the bank, you need to have your independent input into the true strategic direction rather than trying to manage the strategic planning process itself.

2. Don't take too long. A strategic planning session does not have to be a multi-day event. Most organizations will find that about six to eight hours is all that is needed to cover everything. You might simply do that in one day, divide it into two half-day sessions or something similar, but use your directors' time and your management's time effectively and efficiently.

3. Avoid too much esoteric or "touchy-feely" discussion. Strategic planning does not have to be some pie in the sky discussion about what might happen 20 years from now. Rather, focus on the practical implications of what is impacting your bank. Do you need more branches, do you need to expand, do you need to improve sources of non-interest income, do you need to close a location, do you need to eliminate your Trust Department, etc. Spending too much time on your "value proposition" or understanding the nuances of your "deliverables" may be a waste of time.

4. Don't exclude management. You do not need every person in the bank at the planning session, but your most senior management team should be included in at least part of the strategic planning session. You might certainly want to exclude them for part of the session or have two separate sessions, one for the management team and one for the Board, but continue to keep them involved at some level.

5. Don't get "in the weeds". Strategic planning generally is a big picture focus and discussion. You do not need to get into the minute details of every proposal or idea. There will be a time for that in the future (and will probably be handled by the management team), but the initial planning session is not the time. Keep the focus on high level issues.

6. Strategic planning is not budgeting. Do not get hung up on financial analysis, budgeting items or the like. That is a management function anyway. Keep your group focused on the correct things.

7. Avoid wasted time on statistics. If you find it beneficial to cover demographic information, housing information, statistical data from your communities or anything else similar, consider distributing that information to attendees ahead of time for their review rather than discussing each item at the planning session. In fact, consider using a questionnaire to elicit responses on things like your current environment (strengths, weaknesses, opportunities and threats) and to knock out other things prior to the meeting so the meeting itself could be used for substantive discussions.

8. Don't hold the meeting at the bank. Get your group off-site and you will find them more energized, engaged and not running down the hall every five minutes to meet a customer who has come into the bank or running back to their office at lunch to check on things.

9. You should also utilize your strategic planning session to hold "director only" sessions. This gives the Board the opportunity to exercise its fiduciary duties and have candid conversations without the management team being present. In that scenario, it is normally appropriate to allow a President/CEO who is still a member of the Board to remain in the discussions as a director. However, if a Board also chooses to separately have a brief session with only outside directors, that is also appropriate. Remember, however, that these are not secret sessions. Once the director-only session is concluded, it probably is appropriate for the President/CEO who is a member of the Board to report the general discussions to the senior management team and likewise the Chairman should report the outside director-only discussions back to the President/CEO.

10. Don't make it all business. Consider using your strategic planning session for relationship building as well. Yes, you are going to spend the majority of the day doing difficult planning work, but set aside time for a dinner or some other leisure activities as part of your activities.

The strategic planning process is unique to each organization. Make yours practical, substantive and efficient.

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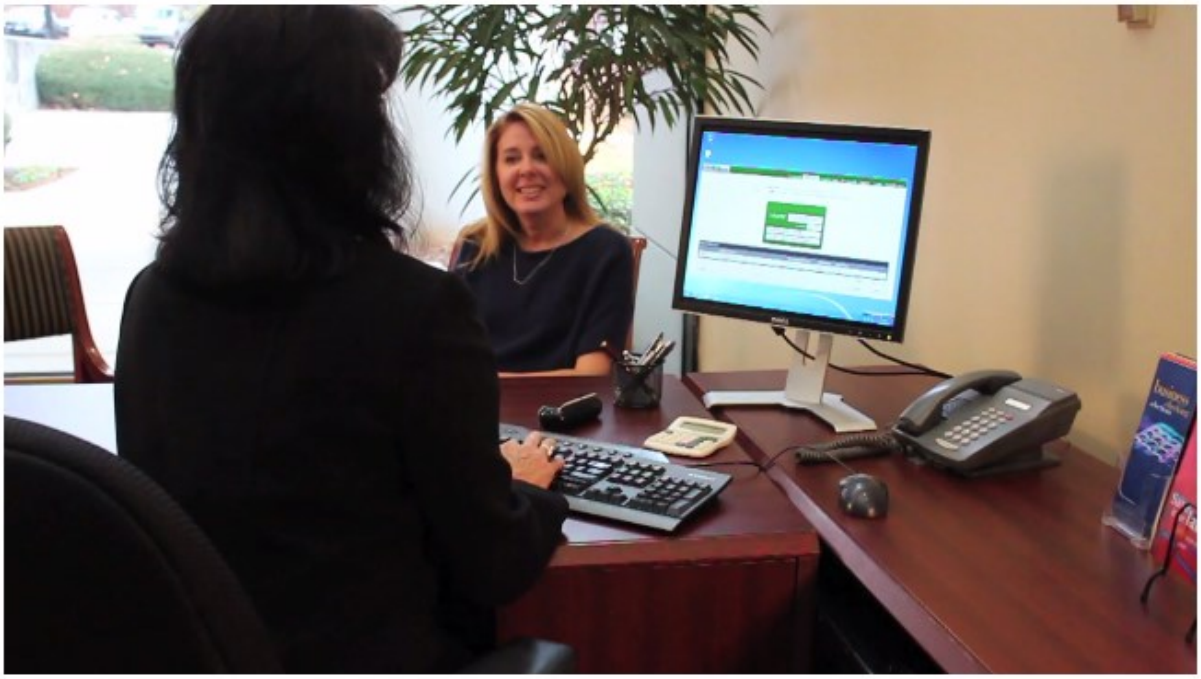

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CECL: The Board's Role in a Regulated Environment

THE AUTHOR.....

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Leads Arkansas' Financial Services Group at BKD, Little Rock. BKD is an ACB Associate Member.

BY GARY EDWARDS

The issuance of the new current expected credit loss (CECL) standard in June 2016 represents a substantial accounting change, and many boards are trying to determine how their institutions will comply with the new standard.

In Frequently Asked Questions on the New Accounting Standard on Financial Instruments—Credit Losses, the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and National Credit Union Administration (collectively, the Agencies) state they expect supervised institutions to make good-faith efforts to implement the new accounting standard in a sound and reasonable manner. Given the likely expectation that CECL will increase allowance levels and lower capital, regulatory expectations will be heightened.

Significant changes in the Allowance for Loan and Lease Losses (ALLL) aren't unique. Institutions can look back just 20 years and recognize regulatory guidance that looked at percentages of classified loans as a measure of ALLL adequacy irrespective of the methodology chosen under generally accepted accounting principles (GAAP). Refinements in 2001 and 2006 furnished guidelines of acceptable ALLL methodologies to provide consistency for GAAP and regulatory purposes. Although mathematically accurate, as seen with the recent financial crisis and long recovery period, it's becoming increasingly difficult to measure and react to changing economic conditions.

A noted benefit to the new standard is the flexibility in determining expected losses. The Agencies recognize this flexibility, but institutions should use judgment in developing estimation methods. Any method chosen should be well-documented, applied consistently over time and provide a good-faith estimate to the collectability of financial assets. Further, the Agencies have commented that smaller and less complex institutions will be able to adjust their existing allowance methods to meet the new accounting standard's requirements without the use of costly, complex models.

So how do financial institutions focus on getting this methodology change right, and what should the board be focused on?

The board of directors plays a pivotal role in the effective governance of its institution by overseeing management and providing organizational leadership through core corporate values. This helps keep the institution operating in a safe and sound manner, and comply with applicable laws and regulations. Directors aren't expected to be actively involved in day-to-day operations, but should provide clear guidance and monitor risk exposure through established policies, procedures and practices. The board, typically through an established audit committee, has broad oversight to monitor the financial reporting process and oversee the financial institution's establishment of accounting policies and practices. In anticipation of implementing CECL, the board should consider reviewing the significant qualitative aspects of the bank's accounting practices, including accounting estimates, financial reporting judgments and financial statement disclosures.

Existing regulatory guidance provides a roadmap of expectations regarding the ALLL methodology, and expectations will likely remain unchanged with the new CECL standard. The guidance states that for an institution's ALLL methodology to be effective, the institution's written policies and procedures should address:

- The roles and responsibilities of bank personnel involved in the ALLL process
- The institution's accounting policies affecting the ALLL
- A narrative of the institution's methodology
- Documentation of the internal controls used in the ALLL process

Some institutions are considering the use of third-party vendors for CECL implementation, and in this case, boards should ensure their institutions have appropriate processes in place for selecting vendor models. As part of this process, institutions should require vendors to provide developmental evidence explaining the product components, its design and proof the product works as expected, with an understanding of the model's limitations. Whether the model is developed in-house or by a vendor, all model components, including input, processing and reporting, should be subject to an independent validation that's consistent with current regulatory guidance. Also, depending on the complexity of the method chosen, certain models likely will be within the scope of the Agencies' model risk management guidelines, and institutions will need to consider ways to effectively challenge those new models.

Boards should become familiar with the new standard and work with management to understand the plan to implement it, based on the institution's size and complexity prior to the applicable effective date. Boards also should make sure they're regularly updated on the status of implementation efforts. It's expected examiners will begin to inquire about the status of institutions' implementation efforts and as the effective date nears, examiners will want to know the new standard's effect on the bank's capital levels.

Implementing CECL will be a significant challenge for institutions that aren't diligent and timely in creating and executing a plan with input from many key stakeholders—including the board. Active participation on the part of directors will be critical in its success.

For further reading and guidance:

- Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions, July 2001
- Frequently Asked Questions on the New Accounting Standard on Financial Instruments—Credit Losses, September 2017
- Supervisory Guidance on Model Risk Management (FDIC), June 2017
- Supervisory Guidance on Model Risk Management (OCC, Federal Reserve), April 2011
- Interagency Policy Statement on Allowance for Loan and Lease Losses, December 2006
- Joint Statement on the New Accounting Standard on Financial Instruments – Credit Losses, June 2016.

Contact your trusted BKD advisor with questions or for more information. *Gary Edwards leads BKD Arkansas' Financial Services Group. He can be contacted at 501.372.1040 or at gedwards@bkd.com.*

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