

# In Touch

June 2011

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## Community Bankers Association of Kansas

# KANSAS COMMUNITY BANKERS PARTICIPATE IN ICBA WASHINGTON POLICY SUMMIT

• PLUS •

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▶ Private Placements: Nuts and Bolts • *page 10*



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## Fight of Our Lives

**Earlier this month,** I had the privilege of attending ICBA's Washington Policy Summit, along with 27 other Kansas community bankers and spouses. The first day, we spent time learning about ICBA's 2011 legislative priorities and how to best communicate those issues with our Kansas congressional delegation. The next day, we headed to the Hill and held meetings with both senators and all four representatives discussing our issues and expressing our concern for the future of community banking in our state. Without exception, every one of our Congressional delegates listened to our concerns and voiced their support for our community banks. We left Washington after three days of meetings feeling as though we had, at the very least, made our issues known and our voices heard.

Prior to joining the CBA as its executive officer, I admit I never took the time or initiative to make contact with any of our elected leaders. In my way of thinking, I just assumed they couldn't care less about talking to a small-town banker who didn't run in the same circles as the D.C. elite. Now that I have been thrust into the legislative arena (due to the financial crisis and my responsibilities to promote and protect community banking for the CBA), I have come to realize I was completely wrong (not something you will normally hear from me ... just ask anyone who really knows me).

I have had the honor of spending many hours talking with our senators and representatives. They are very approachable and not only willing to listen, but truly wanting to learn about community banking and how we are being affected by the actions of Congress. They are honestly concerned about the communities of Kansas — urban and rural alike. Their questions have prompted me to become more involved with the issues, educating not only the actual member, but their staffs as well. If we do not reach out and answer their questions, then who will they listen to? My guess would be the banks attempting to look like us but in truth have nothing in common with us — the community bank wannabes of Wall Street. Since when are the largest banks in the country community banks? How dare they claim to be! I will never understand how they can profess to be just like us, while at the same time, conducting their old business as usual at the cost of the consumer and not caring for the local community. We have let them get away with it for too long by not standing up against them and making our voices heard. No more!

I honestly believe if we want the world to be different, we have a responsibility to make it so. No longer can we hope that someone else will take up the charge and protect us. This association stands ready to fight for you and all our community banks, but it cannot be done without you fully engaged in the fight with us. Please join us at our annual convention July 14-16, at the Sheraton in Overland Park, Kan., to find out how you can join in the fight for community banking and add to our collective strength. •

Shawn



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### • Mike Ewy •



**HOMETOWN** Hanston, Kan. • **FAVORITE SPORTS TEAM** Kansas State University Wildcats and the Kansas City Chiefs • **FAVORITE MOVIE** *Forrest Gump* is definitely in my top five • **BOOK YOU'RE CURRENTLY READING OR JUST FINISHED** "Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System — and Themselves" by Andrew Ross Sorkin • **HOBBIES** Golf and concierge for my kids • **FAVORITE QUOTE** "I don't think the heavy stuff's gonna come down for quite a while" — Carl Spackler of *Caddyshack* on the current state of the banking industry. Actually, my favorite quote is, "If you always do what you have always done, you will always get what you have always got."

**Mike Ewy** is president and CEO of Community State Bank in Coffeyville, Kan.

### Q What is your background in banking and with Community State Bank?

I began my career in 1982 as a lender with the Federal Land Bank. I started my commercial banking career in Choctaw, Okla., in the lending area and worked for two other banks prior to becoming CEO at Community State Bank in 2000.

by Alex Peak,  
Assistant Editor,  
BankNews Media

### Q What is the bank's history? When was it founded?

The bank was founded in 1967 by a group of Coffeyville citizens. The bank was sold in the 1970s to another local group, and then sold again in the early 1980s to a group from out of town. In 2003, the bank was purchased by a group led by Coffeyville citizens, and we are proud to be Coffeyville's only locally owned and operated community bank.

### Q As Coffeyville's only locally owned and operated bank in town, how does it stand apart from its competition?

We think our staff's involvement in community organizations and the bank's financial support of the various activities make our town a real community. And that is an important part of what makes Community State Bank stand apart. I don't think there are many boards or committees in which we don't have someone actively involved, and we try hard to financially support various community projects.

### Q What do you think are the biggest differences between being a community banker in a small town versus a large city? Are there any similarities?

I may be wrong, but I don't think the president of a large city bank gets calls on the weekend when the ATM isn't working or when a customer's checkbook is stolen. Having that personal relationship with my customers is special to me. The similarities are that all banks deal with the same issues of providing financial services to their customers.

### Q There are a lot of obstacles and challenges community banks are faced with today. Have you had any recent successes or achievements at the bank?

I am lucky to work with a great banking team, and we search for efficient ways to absorb the

► *"I may be wrong, but I don't think the president of a large city bank gets calls on the weekend when the ATM isn't working or when a customer's checkbook is stolen."* ◀

new regulations and still provide a return to our shareholders. The bank was selected as the Coffeyville Area Chamber of Commerce business of the year for 2009.

**Q** How has your membership with the CBA helped with your role as president and CEO?  
As with any membership organization, one of the best values are the relationships you create with other members through the various activities. Those relationships can be a great

resource when you face situations that are new to you but not new to them.

**Q** For you, what is the most satisfying part of being a community banker?

I grew up in a town of around 250 hard working folks, and then there was me. The local bank was always involved in everything good that took place in town. My goal was to be that kind of bank for Coffeyville. I hope the community would agree that we are trying to do our part. •

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# PRIVATE PLACEMENTS: NUTS AND BOLTS

*BY PETER WEINSTOCK AND MICHAEL KEELEY*

**R**egardless of the security offered, banks and bank holding companies more and more are seeking to raise capital from their shareholders and their communities. These offerings are typically structured as private placements in order to avoid the time and cost of federal, or even state, registration. Accordingly, bankers should be at least generally familiar with the nuts and bolts of the available exemptions for such an offering. Otherwise, the subscribers will have a number of remedies, including the right to rescind their investment.



At the outset, in order to offer and sell securities, the securities issuance must be registered with the U.S. Securities and Exchange Commission (the SEC) and the applicable securities commission of each state in which the issuer would be offering and selling securities, or the issuer must be exempt from registration. In addition, the people selling the securities must be licensed brokers or associated persons of the issuer. An exemption from such requirement is generally available for directors and executive officers.

### Exemptions for banks

Bank stock may be sold without compliance with the registration requirements of the federal securities law and generally state securities laws, as well. The SEC defers most regulation of such offerings to bank regulators. The Federal Deposit Insurance Corporation does not generally

review offering documents, but may require review of an offering document pursuant to an administrative action or for de novo banks. In addition, the FDIC expects all banks issuing securities in a public offering to comply with its policy statement regarding disclosure of material information. The Federal Reserve Board does not review offering documents of state nonmember banks. In contrast, national banks must seek the review by the Office of the Comptroller of the Currency of their securities offerings. The OCC regulations adopt many of the SEC's rules and generally require the filing of an offering circular for any securities offering by a national bank unless another exemption is available.

Even though bank securities offerings are exempt from the registration requirements of the Federal Securities Act, the sale of bank securities is still subject to the antifraud requirements of the federal securities laws. This requires an offering document to include all information concerning the bank and the offering that a reasonable investor would find to be material. Generally, the bank will consider the requirements of the federal securities regulations for disclosure documents as a benchmark in preparation of the offering document.

### Bank holding companies

In contrast, the SEC does regulate the offer and sale of securities by bank holding companies. Many different exemptions exist, but this article only describes those most commonly used by community bank holding companies. These exemptions generally restrict the type of purchasers in any securities offering and the geographic boundaries of the offering.

### Intrastate exemption

The federal securities laws have jurisdiction to regulate only the offers and sales of securities through the interstate mail. Therefore, the law specifically exempts an offering conducted entirely within one state. The SEC has certain requirements to meet the intrastate exemption. First, the bank holding company must be incorporated in the state that it intends to offer and sell the securities. Second, all individual purchasers and offerees must reside in the same state. Any institutional purchaser must also have its principal business office within that state. This exemption is an offeree exemption, so securities cannot be offered to any individual or institution outside the state. Next, no purchaser can sell his or her securities to anyone residing

in another state within nine months after the final sale of the offering. This is the most difficult requirement because the holding company must “police,” through stop transfer instructions and legends placed directly on the stock certificate, such resales. If these requirements can be met, this exemption provides a viable alternative to a bank holding company wishing to raise capital on a local level. The holding company still would need to consider whether a state exemption or state registration will be needed.

## The Regulation D exemption

If a bank holding company desires to make an interstate offering, the most feasible exemption is what is commonly known as a Reg D offering, comprised of Rules 501-508 of the federal securities regulations. Reg D places certain limitations on the size of the offering and the type of purchaser rather than on the location of the offerees. Reg D covers three types of offerings and imposes a sliding scale that requires more sophistication for purchasers. Reg D also requires that purchasers be provided additional information as the amount to be raised increases.

An offering of up to \$1 million has no limitation on the number or sophistication of purchasers. Under Rule 505 of Reg D, offerings up to \$5 million may be made to an unlimited number of “accredited investors” (as that term is defined below) and 35 additional nonaccredited investors. Generally an accredited investor requires a certain amount of earnings or net worth and a relationship to the issuer. The holding company must be able to prove the investors are accredited.

Offerings more than \$5 million also may be exempt under Rule 506 of Reg D. Each purchaser who is not an accredited investor must meet certain other standards. Each nonaccredited investor, however, must have “such knowledge and experience in financial and business matters that he [or she] is capable of evaluating the merits and risks of the prospective investment.” Therefore, in large offerings, all investors must have some degree of sophistication.

Finally, all Reg D offerings require delivery of an offering document to all nonaccredited investors. Again, the disclosure document must meet Rule 10b-5 requirements. A Form D describing the offering must be filed with the SEC within 15 days of the first sale, which the SEC deems to be the date the issuer receives its first subscription agreement.

## No general solicitation or advertisement

A private placement offering, including an offering relying on the exemption under Rules 505 and 506 of Reg D, must be

conducted through the distribution of a confidential private placement memorandum. Neither the issuer of securities, nor any persons acting on its behalf, may offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, any advertisement, article, notice or other communication published in a newspaper, magazine, or similar media or broadcast over television or radio, or at any seminar or meeting the attendees of which have been invited by general solicitation or general advertising.

The analysis of whether an offering constitutes a “general solicitation” is very fact-sensitive. Courts and the SEC have interpreted the prohibition on “general solicitation” to mean, generally, that there must be a pre-existing relationship of some kind between the issuer of securities and the prospective purchaser, such that the issuer would be aware of the financial circumstances or sophistication of the prospective purchaser. If the relationship were itself created through a general solicitation or advertisement (such as through the distribution of a questionnaire), then there must be a sufficient time lapse between the solicitation and a subsequent offering so the original solicitation is not deemed to be connected to the offering.

To avoid an offering deemed to be by means of general solicitation, the following guidelines should be followed:

1. The issuer may not use advertisements, handbills, form letters or other general solicitations to solicit potential offerees specifically in connection with the offering.
2. The offer of the securities will only be made by means of the confidential private placement memorandum (PPM).
3. The PPM will not be delivered to any person with whom the issuer or its principals does not have a substantive, pre-existing relationship.
4. The issuer will identify each PPM it sends out by indicating on the cover the number of the PPM (starting with #001) and the name of the qualified offeree to whom it is sent. Each successive distribution of that particular PPM number must also be tracked to its ultimate distributee. The issuer will maintain adequate records of the number and names of the persons contacted in connection with the offering and of the nature and extent of the relationships with them, including a log identifying to whom each individually numbered PPM was sent.
5. Release of the PPM should require the approval of some person or persons who have undertaken a preliminary inquiry as to the prospective qualified offeree.
6. The issuer must not engage third-party intermediaries to provide names of persons as prospective offerees.

## Accredited investors

As discussed above, a private placement offering may be made to an unlimited number of accredited investors. In order to be an accredited investor, the issuer must have reasonably believed, at the time of the sale of the notes, the investor fell into at least one of following categories:

- A natural person whose individual net worth, or joint net worth with his or her spouse, exceeded \$1 million excluding the net equity in the person's home, unless the homeowner is "upside down" in the investment;
- A natural person who had an individual income in excess of \$200,000 or joint income with his or her spouse in excess of \$300,000 in each of the two most recent years, and had a reasonable expectation of reaching the same income level in the current year;
- A director or executive officer of the issuer;
- A trust, with total assets in excess of \$5 million, not formed for the specific purpose of acquiring the securities, whose purchase was directed by a "sophisticated person," which is defined under Reg D;
- An entity in which all of the equity owners satisfied one of the definitions of "accredited investor";
- An organization described in section 501(c)(3) of the Internal Revenue Code with total assets in excess of \$5 million;
- A private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940; or
- Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any insurance company as defined in section 2(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that Act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5 million; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary,

as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of \$5 million or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors.

## State securities laws

In addition to federal securities laws, an offering will also need either to qualify for an exemption from registration from state securities laws of each state in which the issuer has subscribers, or to have the issuer engage in a state registration. Most states have exemptions that cover private placements. In some cases, a notice of sale may be required to be filed with the securities commissioner of applicable states.

## Potential for revised rules

On April 6, 2011, SEC Chairman Mary Schapiro notified Congressman Darrell Issa (R-Calif.) that the SEC's staff is "taking a fresh look" at its capital formation rules in order "to reduce the regulatory burdens on small business capital formation." One area Schapiro believes requires SEC examination is the requirement that private companies with 500 or more holders of record register their securities. She noted the proposed legislation by Sen. Kay Bailey Hutchison (R-Texas) to establish a 2,000 record holder threshold to reduce the regulatory hardship suffered by community banks under the existing 500 holders of record threshold. Whether the SEC will increase this limit and by how much remain unclear. The SEC has also indicated it will consider whether the general solicitation ban should be revisited in light of current technologies, while maintaining the SEC's mandate to protect investors and augment capital formation. Finally, Schapiro indicated the SEC will examine the regulatory questions posed by new capital-raising strategies such as special purpose vehicles and "crowd funding."

Please note that this is not an exhaustive treatment of this issue. A number of additional regulations exist that an issuer must meet to qualify for these exemptions. •

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# BANKS MUST FIGHT CYBER CRIMINALS



BY JEFF MULTZ



**T**he biggest bank heists don't come from the same formidable techniques used by Willie Sutton or Bonnie and Clyde. These days, in mere minutes hackers plunder bank accounts via the Internet, often through holes in website applications.

Using Web application attacks, cyber criminals can steal funds, private information and entire databases from companies.

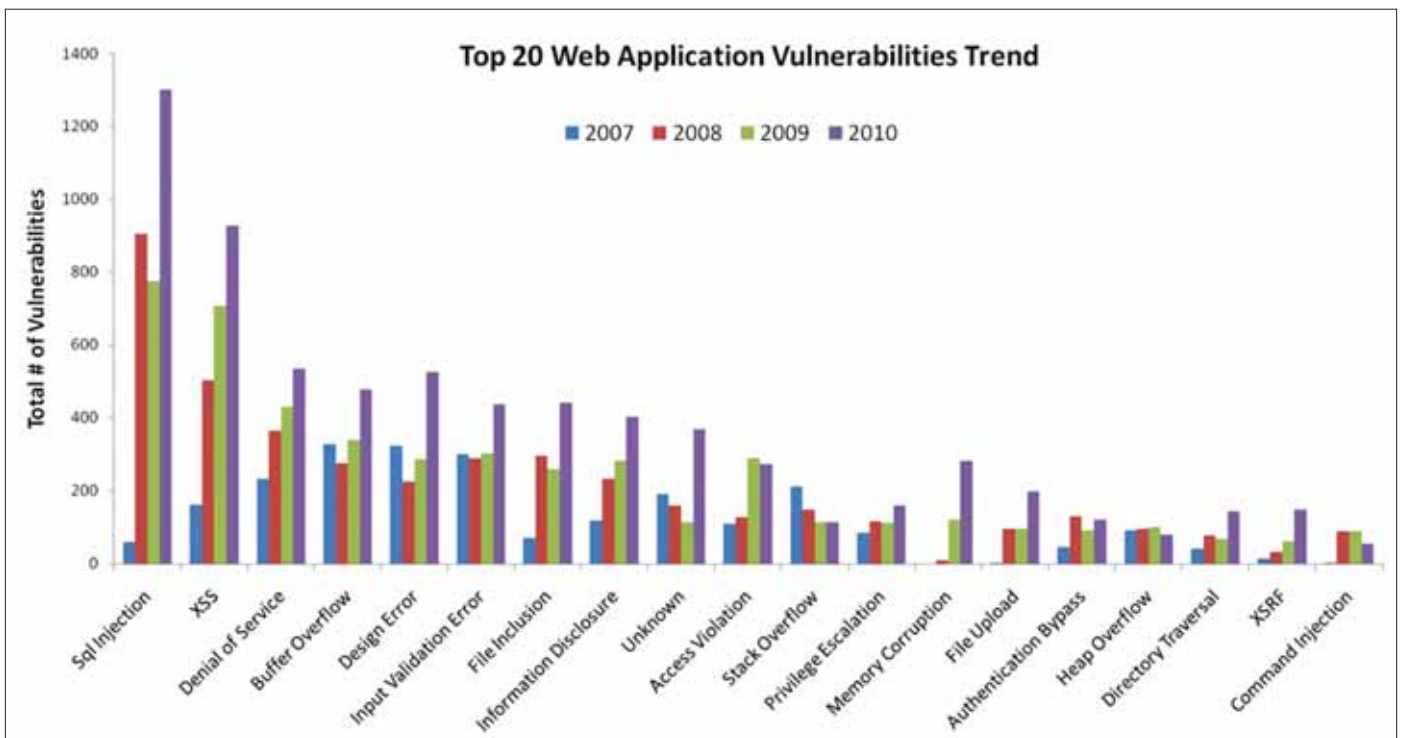
It sounds amazing, but hackers can sneak into a bank's website and network through Web pages that contain an open field or boxes into which computer users type a username or password.

Computer programmers create Web pages using code, or computer language, such as HTML or JavaScript. Typically, programmers are tasked with creating an application that works and getting it to the client as quickly as possible. So if a bank wants a programmer to create an application that allows its clients to transfer money or write a check, programmers create the

application as quickly as possible. If the application works and online users find it easy to navigate, the bank and customers are happy. At least for a while.

Often, programmers either don't know how to write code securely or don't take the extra time to do so. Unless banks check the code with a security expert, they won't realize the code may contain holes or vulnerabilities, which could allow intruders to hack the website and access files on its computer network.

Although hackers use many methods to breach websites, the most popular method, which has been used for years, is called SQL injection. That is when a hacker injects malicious code into an open field.



For example, in the slot where someone should enter a username, a hacker could type in a code, something like “OR 1=1#>.” Once the hacker enters the malicious code, the hacker could acquire access to the administrative part of the bank’s website, where he could change the way the website looks and obtain access to any documents on the network. That might include company trade secrets, as well as clients’ usernames, passwords and bank account information.

Many bank executives think that just because they are “Web compliant,” their system is safe. Basically, compliance rules tell banks to be sure to lock the doors and windows of their websites so no hacker can get in. But the rules don’t show where the doors and windows are or how a business can lock them. And, just because the doors are all locked one day, it doesn’t mean they remain locked 24/7/365.

Numerous vulnerabilities exist throughout a network system. And banks that have been compliant have been hacked, costing them hundreds of millions of dollars, as well as damage to their reputations. For their

own safety, banks would be better off approaching security first and compliancy second because compliancy will not necessarily keep a company secure. A good security consultant will automatically review the steps a company should take in order to be secure and compliant.

So what should an organization do to be secure? Plenty. There is not one single layer of protection any organization can implement to ensure safety. It is the sum of many layers of protection that will keep most criminals away so they look for easier prey.

The first thing banks should do is hire a security expert to review the source code for all the pages on their websites. Each time the source code is changed to add a new feature to the website, make sure a security expert reviews it.

If a business does not have its source code, it should employ a security expert to try to break into the site using numerous hacking techniques. This is called “penetration testing” or “Web application reviews.”

If any vulnerabilities are found, fix the code as soon as possible.

Additionally, banks should install, maintain and continuously monitor a Web application firewall to prevent Web applications from being infiltrated while the code is being fixed or tested. Banks should also perform external Web application scanning on an ongoing basis, at least quarterly and every time it deploys new code.

Last, retain security experts to monitor your server and firewall logs 24/7/365, in real-time. If a bank has security professionals monitoring logs just a couple of times a day, by the time it sees the malicious activity that has hit the website, the hacker likely has acquired access to the site’s financial information and stolen its crown jewels. •

• ABOUT THE AUTHOR • • • • •



Jeff Multz is vice president of Dell SecureWorks, a market leading provider of world-class information security services

worldwide, spanning North America, Latin America, Europe, the Middle East and the Pacific Rim. He is a former computer programmer for financial institutions.

# KANSAS COMMUNITY BANKERS PARTICIPATE IN ICBA WASHINGTON POLICY SUMMIT

**C**BA participated in two days of Congressional visits as part of the Independent Community Bankers of America's Washington Policy Summit, which took place May 2 and 3 in the nation's capital.

“Bringing ICBA member community bankers to Washington to talk one-on-one with their representatives is key to ensuring the community bank perspective is heard loud and clear on top of community bank issues such as the Tester/Corker Interchange bill, the harsh regulatory examination environment, suffocating regulatory burden and reforming the housing-finance GSEs,” said Sal Marranca, ICBA chairman and president and CEO of Cattaraugus County Bank, Little Valley, N.Y., and a participant in the event. “The community bankers who attended made a difference at this critical time for Main Street — proving once again that community banks truly are the financial foundation of our nation and the economic engines that drive prosperity and well-being on Main Street.”

Each year, the ICBA Washington Policy Summit brings community bankers from across the country to Washington to meet with their members of Congress and federal regulators, and to discuss a wide range of issues that affect community banking. This year, the nearly 1,000 attendees heard from Sen. Mary L. Landrieu (D-La.), Rep. Spencer T. Bachus III (R-Ala.), Blaine Luetkemeyer (R-Mo.), Deputy Treasury Secretary Neal S. Wolin and Federal Reserve Bank of Kansas City President Thomas M. Hoening.



“Personal contact with lawmakers is the most effective way for the CBA to educate the representatives in Washington about the issues facing Kansas community banks, their customers and the local communities, which they so proudly serve each and every day,” said Shawn Mitchell, president and CEO, CBA. “It’s vital for Kansas bankers to have our voice heard in Washington so we can let our members of Congress know what issues we need addressed back home to make our communities an even better place to work and live.” •



# Upcoming Education

## June

28 Personal Account Documentation & Signature Cards  
TELE/WEB SEMINAR

30 Health Care Reform Issues for Community Banks  
TELE/WEB SEMINAR

## July

6 Lender Liability Issues  
TELE/WEB SEMINAR

7 Ownership Issues for Directors  
TELE/WEB SEMINAR

12 Best Practices for Board Package Preparation  
TELE/WEB SEMINAR

14 What are Those Business Financial Statements Telling Me?  
TELE/WEB SEMINAR

19 Call Report Preparation: RC-R Risk Based Capital  
TELE/WEB SEMINAR

20 Assessing New Remote Deposit Channels: Risk Mitigation, Fraud Prevention & Regulatory Compliance  
TELE/WEB SEMINAR

21 Identifying & Responding to Fraud & Forgery in an Electronic Payments World  
TELE/WEB SEMINAR

26 Business Signature Cards & Resolutions  
TELE/WEB SEMINAR

26-27 Anti-Money Laundering & BSA Compliance School  
PBS SEMINAR

28 Safe Deposit Legal Issues  
TELE/WEB SEMINAR

For more information about these seminars, contact the CBA office at 800-258-4589 or [info@cbak.com](mailto:info@cbak.com). Or visit [www.cbak.com](http://www.cbak.com), and click on the Education & Training tab to view seminars by category or by calendar date.



## 2011 CBA Convention PAC Auction

July 14-16

Help make this year's PAC Auction a memorable one!  
PAC Auction items can be *anything*.

Unique, creative and fun items are great! What about a hotel stay as a get-away? Perhaps a local artist or craftsman has a special item you can donate. Will you be visiting another area?

Sometimes great items are found away from home. Anyone can donate. Although the proceeds from the auctions will go towards the CBPAC fund, the donors of the items to be auctioned are not subject to the PAC donation laws. In addition to bankers, CBA Associate Members and Exhibitors are also welcome to donate items for the Tradeshow Auction as well as the Live Auction. Everyone can join in the fun of bidding on the items during the CBA Convention!

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# In Touch

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