

M A G A Z I N E A R C H I V E S

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Building a De Novo Board from Scratch

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There are many issues to consider when assembling a new board. We've canvassed de novo bankers and consultants to bring you their best advice on building the most effective board right from the start.

In bank start-ups, selecting board members is arguably the most important task an organizing group will undertake. To begin, which members are selected will determine how successfully the bank can raise money, the first prerequisite for survival.

"Their main function, aside from setting the strategy of the bank, is to push business forward," says Tim Telman, president and chief executive officer of Hyannis, Massachusetts-based Bank of Cape Cod, which opened last year and has garnered \$23 million in assets. "You need to pick a board that is going to help the bank get business. That's the most critical part of a de novo board."

Organizers need to consider several things when selecting a board member: his or her standing in the community, background, business acumen, affiliations, age—and ultimately, the prospective director's ability to bring in dollars. They also need to think about how large a board they want. In essence, the people selected for the board will set the tone for the organization.

ESTABLISHING CONNECTIONS

The initial board plays a critical role in terms of raising capital and bringing in the business that will get the new bank off the ground. The first \$25 million to \$50 million in loans and deposits generally comes from relationships that are a result of contacts made by the founders, directors, and management team, estimates FinPro Inc., a bank consulting firm in Liberty Corner, New Jersey. By FinPro's reckonings, if investors bring in \$4 to \$5 for every dollar of equity capital invested, the stock price will go up.

Accumulating such investments means initial board members must have a local presence. "You are looking for people who will represent the community that you're going to serve—people who are well respected," says Randy Dennis, president of DD&F Consulting Group, a Little Rock, Arkansas firm that works with start-up banks. "In today's world, they talk a lot about the tone at the top. The president and the board set the tone for the organization. Nowhere is that truer than in community banks."

In terms of recruitment, connections are invaluable. Tom Hassey, a former radio station owner, is in the process of organizing banks in California, Texas, and Arizona. He has lived in each state and is now tapping friends and associates from San Diego, Dallas, and Tucson, Arizona. These connections are also highly motivated to give something back. "These are old-time friends of mine who I know want to contribute to the community," Hassey says. "Banking ... is more than just money. It's a way to be an integral part of a community."

Connections can also help create a diverse board, which the new bank will need to reach as many different spheres of influence as possible. Frank Sorrentino, chairman and chief executive officer of North Jersey Community Bank, a \$180 million institution headquartered in Englewood Cliffs, New Jersey, knows the value of contacts. His first recruit: Joseph Parisi Jr., a friend and businessman, as well as the town's mayor. Once he established the connection to Parisi, it opened a whole other set of doors to others.

"I got involved with prominent community and civic leaders in the area and said, 'I want people to be on our board who know, understand, and are connected to just about everybody,'" Sorrentino says. "That took a lot of thinking."

THE TALENT POOL

Encouraging board member diversity helps a new bank draw on many different trades and social networks it needs to maximize the raising of capital. Generally, at least one or two members must have prior bank experience. Beyond those, advisers urge groups to get creative.

Donald Musso, president and chief executive of FinPro, suggests tapping lumberyard owners because they know all of the trade workers in the community. Real estate developers also can bring in a lot of business. Presidents of local chambers of commerce and other associations offer additional networking opportunities. Construction contractors make great bank directors, adds Dan Hudson, president and chief executive office of Bankmark, a consulting firm based in Dallas, because they cut across the spectrum of building trades and come in contact with many people each day who are in need of specialized financing. Physicians who are specialists are also good professionals to target because they deal with networks of doctors with whom they rely for referrals—which could translate into potential business for a de novo. Yet while leads to referrals are a big plus, Hudson notes that at least several members of the board need to have management experience running large businesses or divisions of corporations. Owners of national franchise operations also make good candidates.

While knowing who to recruit is critical for start-up organizers, sometimes it's just as helpful to think about whom not to place on a board. Before Frederick County Bank, based in Frederick, Maryland, opened in 2001, it shied away from recruiting accountants, attorneys, and commercial real estate professionals. The fear: if lawyers and attorneys were referring business to the bank and saw a competitor among their ranks, they might be reluctant to share a customer.

"We rely heavily on referrals from the legal, commercial real estate, and accounting professions, so we wanted to make sure we were not giving those people any excuse not to send us business," says Martin Lapera, president and chief executive officer of the \$222 million bank.

Some advisers are reluctant to recruit certain categories of professionals as board members. For instance, Hudson advises organizers to stay away from attorneys—but for a different reason. "Litigators want to argue everything," he warns. He also is wary of engineers because, he says. "They want to re-engineer the process—\$2 million later, you don't have a bank." Nonetheless, he says, "there are still plenty of attorneys and engineers who make good bank directors, but you need to be cautious of the traits of those professions."

No matter what their predisposition or background, new directors must be savvy, energetic, and willing to buy into the business plan. "We really needed board members who possessed a couple of different skills," Sorrentino says. "One was good business acumen. We also needed people that understood the philosophy of a being highly customer-centric, as opposed to 'We're just in this to make a buck.'"

"You want to have a board that represents a serious group to your marketplace," adds Mark Giles, chief executive officer of Virginia National Bank in Charlottesville, Virginia. For example, Charlottesville is home to a prominent medical community, including the University of Virginia Hospital and Martha Jefferson Hospital, so Giles tapped a well-known neurosurgeon to be on the original board, along with a mix of well-placed Charlottesville businesspeople.

This is critical not only for bringing in business, but also for raising capital after the charter is received. "You want to have people who are going to do what they can for the bank," Giles says. "Whether it's bank introductions or opening doors, you've got to make sure you're dialing into who they are. Somebody who is uncomfortable making introductions or making calls can sometimes help you in other ways, but [on the whole,] you've got to make sure it's a group that understands there is some energy and heavy lifting that has to go on."

Board members' ages should also be considered. Sorrentino's board ranges in age from early 40s to early 50s. He believes directors in their late 60s and 70s bring a different view and are less likely to be geared toward longterm prospects. Sorrentino and his board see North Jersey Community Bank as being around for a long time to serve Bergen County, which contains many affluent suburban communities northwest of New York. "As you get older, things change," he says.

On the other hand, choosing businesspeople who are too wrapped up in their day jobs won't help either, advisers warn, because serving as a director of a de novo bank will take time in terms of bringing in business to the bank and sitting on committees. They might look good on paper, but the reality is often different. "I don't want a bunch of 40-year-old absolute entrepreneurial go-getters who don't have any time to give to the bank," says Musso of FinPro. "The bank is going to take a certain amount of time and effort." For that reason, Musso often seeks retired regulators because they are well qualified to serve on loan and audit committees, and they obviously come with the kind of experience agencies are looking for.

To be sure, directors will need to spend a considerable amount of time with a start-up, notes Chet Fenimore, a partner in the financial institutions group at the Austin, Texas office of Jenkins & Gilchrist. Aside from the audit, asset liability management, and compliance committees, directors will be needed for a premises committee to negotiate land purchase and leases and a technology committee to help pull together the bank systems that will be used. "Make sure they understand the expectations," Fenimore says. "It's a lot of work to form a bank and become an organizer."

Finally, independence is a mandatory trait—having board members who are willing to speak their mind and not become a rubber stamp for management. According to the FDIC's *Pocket Guide for Directors*, "Critical evaluation of issues before the board is essential. Directors who routinely approve management decisions without exercising their own informed judgment are not adequately serving their institutions, their stockholders, or their communities."

"People sometimes try to create boards [comprising people] they know are going to agree," Sorrentino says. "That's a big mistake. There is going to be no progression in that type of board—no independent thinking. I never go into a board meeting thinking it will be my decision. [I know] we are going to have a constructive discussion about the issues. When we do leave the board room, we are all in agreement. Once a decision is made, everybody stands behind the decision and moves forward. If you don't think you can put a board like that together, you are shortchanging yourself."

Adds Dennis of DD&F Consulting: "You want people who are community leaders other folks look up to—people who will give you good advice and wise counsel on how to run that bank. You don't want yes-men. You want people that will tell you what they really think."

BACKGROUND CHECKS

In recruiting directors, organizers need to thoroughly vet candidates, beginning with general character and experience questions. They also need to include key disqualifier questions, Fenimore says. Some examples: Has the candidate ever

defaulted on a loan? Has the candidate declared bankruptcy?

Applications to regulators need to disclose any past transgressions, because if not, the regulators will probably be the ones to find them. Regulators will perform background checks on all proposed organizers, directors, and management staff, warns Hudson of Bankmark. He notes that typically, regulators will review records from all or some of the following agencies: the Drug Enforcement Administration, Federal Bureau of Investigation, Central Intelligence Agency, Internal Revenue Service, and National Association of Securities Dealers—in addition to local law enforcement agencies. They will look to see if there are criminal records and whether a candidate has been involved in financial trouble—such as personal bankruptcy or loan defaults. Past bankruptcy is a huge red flag, greatly diminishing chances that a candidate will be approved. Regulators also will check to see if any candidate was involved in savings and loans failures going back to the late 1980s and early 1990s.

Sometimes even the sins of youth can nix a candidate's chances. Musso tells the story of a director candidate who, as a young college student, proceeded to relieve himself on a parking meter after a football game. A local campus security officer tried to get him to stop but the young man became belligerent and was subsequently arrested. The incident came to light in his background check. While theoretically records are expunged after a certain period of time, they often are stored for many years, in part due to the proliferation of security companies that store old data. Federal agencies also hold onto it. "The data is out there and it is never thoroughly erased," Musso says. "Whatever you have done, it's going to come back to haunt you."

HOW BIG A BOARD?

Organizers also must figure out how many members to recruit. Sizes of boards on de novos vary, depending on the business strategy of the bank. North Jersey Community Bank decided to put together a smaller board that allows it to be more flexible. "We wanted a very nimble organization that can make decisions quickly," Sorrentino says. "If you have too many directors, it's an onerous task just to get them together. We did this with the understanding that more board members can bring you more contacts. But doing things in a timely fashion was much more important to us."

To be sure, larger boards will afford more tentacles into the community. Virginia National Bank recruited 16 directors to maximize its reach. Doing so helped it eventually raise \$18.7 million in capital. Yet, aside from making it more challenging to schedule meetings, banks should make sure a bigger board doesn't bog itself down. "We didn't fall under the rule of everybody feeling like they had to say something and had to sound smart," Giles says. "That's really necessary if you've got 16 directors. You've got to have people not speaking unless they have something to say."

REMEMBER YOUR BANK'S PURPOSE

Prospective directors must ultimately understand why they are being called to duty, executives and advisers say. Most understand they must be willing to help a bank serve the community. But first and foremost, they are there to garner deposits, bring in business, and to guide the bank in the direction of generating a healthy return for shareholders. "The process of the formation of the group has a lot of ramifications today," says Hudson of Bankmark. "In the old days, if you could write a check for \$25,000, you were in. Today, it is more strategic. You need criteria for selecting a bank board member. It's not always the richest kid on the block."

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