Room for More...

De Novo Banking in New Jersey

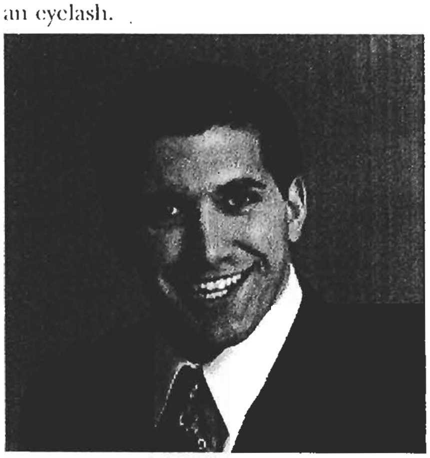
The Phoenix had it easy — it rose anew from ashes. It had something to work with.

When a de novo bank is born — or more accurately hatched — its founders and management team are attempting to create a living and growing entity simply from their hearts and heads.

Instead of ashes, a de novo is borne from imagination, insight, good will, sound judgment and a mixture of years of experience and the courage of trailblazers.

Yet de novo banks also grow under an unforgiving game clock and the watchful eyes of state and federal regulators, who first approve their charter and then closely monitor their progress, measuring it against both financial performance expectations and their own business plans.

It is a paradoxically whirlwind process that makes a workday feel like a month yet burns away five years in the flutter of an eyelash.

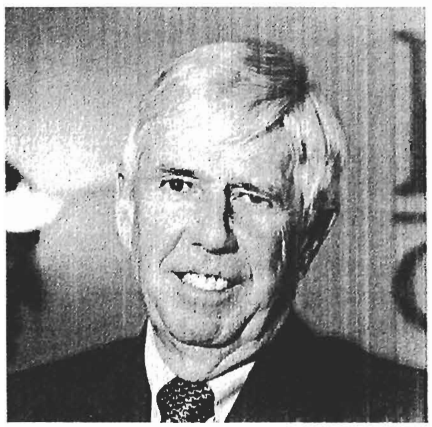


Scott C. Martorana
Managing Director
FinPro, Inc.

According to de novo veterans, the life story of a de novo bank begins when a group of organizers or founders come together because they see an opportunity for a new bank. The organizers generally secure a management consulting company and/or form an advisory board.

Next comes a business plan and formation of the management team, including the key position of president. Bank leaders then determine a location and begin staffing.

This process — which includes regulatory review and approval — generally takes 18 months.



Peter Kenny
President
Heritage Community Bank

Only then does the front door open — and the clock start. According to experts, to survive, a de novo bank must raise significant capital up front and reach $100 million in assets before realizing a profit, which generally will take two-and-one-half to three years or more. All the while de novo banks are visited and reviewed more frequently than older banks and given less leeway in straying from their business plans.

William Heath
President & CEO
RomAsia Bank

While creating a de novo bank and leading it to a successful fifth birthday is a grueling exercise that places an immeasurable weight on founders and senior management, veterans of the process feel the rewards are worth the efforts and that the outlook for de novo banks in New Jersey is bright.

Kevin Lenihan
President & CEO
Indus American Bank

A group of de novo veterans recently shared their thoughts about this unique segment of New Jersey's community banks. Kevin Lenihan is president and CEO of Indus American Bank in Iselin. William Heath is president and CEO of RomAsia Bank in Monmouth Junction. Peter Kenny is president of Heritage Community Bank in Randolph. Scott Martorana is managing director of FinPro, Inc., a management consulting firm that specializes in guiding de novo banks. Terry McEwen, director of banking at the New Jersey Department of Banking and Insurance (DOBI), also shared his thoughts from the perspective of a regulator.

The story of a de novo begins with the organizers.

"You need a core group of committed individuals that bring experience and business acumen," said Lenihan. "They have to know a lot of people and be respected in order to gain the trust of investors. The idea (of the new bank) plays a role, but people are investing in people."

McEwen concurred.

"Regarding Organizing Groups, we prefer diverse business backgrounds and disbursed ownership," he said. "Banking experience is preferred but a strong business history is acceptable…CPAs and attorneys often bring a valuable skill set. Ties to local groups and investors are also important. Organizers are expected to promote the bank and encourage their contacts to do business with the institution."

A strong business plan also will help drive that.

"Growth is one of the most important things for a de novo so you need to develop a business plan that will drive growth," Martorana said. "Profitability for a lot of de novos now is being pushed to $100 million in assets or higher. You have to make sure you're putting together a plan that can get to that point."

Proper staffing also is essential for the success of a de novo, starting with the top.

"Experienced senior management is critical for success," McEwen said. "A President/CEO should be an established banker with a proven record. A senior lender with extensive experience and loyal loan customers is also vital as new banks need to be able to originate loans to earn income."

While regulators prefer for de novo CEOs to have de novo experience, it is not a requirement, nor is it for other members of management. Balance is, experts say.

"You might need to go outside the banking industry for some of your talent," Martorana said.

Front-line staffing also is key for a de novo, often due to its target audience. Indus American serves a South-Asian community.

"I like to hire from the area," Lenihan said. "They speak the different dialects. They know the neighborhood and the people. Because of the different types of people you're trying to attract, you have to understand the culture, the language and the religions involved."

RomAsia serves a very ethnically diverse community, including Indian, Pakistani, Chinese, Korean and other Indonesian cultures, and the bank had to balance serving that community with finding qualified people, according to Heath.

"I was challenged to find an Asian staff since we are focused on serving an Asian community," he said. "Although you'd like to have all ethnic people, you need some experience also, so you have to bend some."

Siting a de novo bank is equally important, for both business plan development and building business.

"Location is interrelated with the founding group and advisory group," Kenny said. "You need your founding group to come from a cohesive location. That's where their business contacts are. You need that cohesive tie with the community."

Like their community bank cousins, de novo banks have an advantage over larger and more established banks in that by being new they are more flexible and adaptive than their competition.

"De novos can be quick and nimble when it comes to decision-making," Martorana said. "They can quickly change course and embrace a new business opportunity."

Added Kenny, "We try to encourage autonomy and make a difference in how the customer is treated. We can make a decision on the spot. We try to empower our bank managers to make decisions. And we stand behind them."

In the area of customer service and product offerings, de novo banks are painting a blank canvass, which allows them to better attract and serve the customer and then build on that new relationship.

"We are a consultative lender," Kenny said. "We'll try to make a deal come together when it might not fit the formula."

New products also allow de novos to respond quickly to targeted customer needs.

"I've introduced several products that are targeted to my customer base," said Lenihan. "We offer free money (wire) transfer to India. We offer free credit card programs to immigrants. Trade finance service. These are all products that appeal to a particular market segment."

RomAsia is investigating various structures that will provide banking services that comply with Shari'ah Law to serve an unmet need within the American-Muslim community while also meeting U.S. banking laws and regulatory guidelines.

"These are financial transactions and products that the very religious Muslim wants and that very few places are offering," Heath said.

Being the new kid on the block sometimes carries other attractive advantages, as well, such as having the newest toys. De novo banks usually open their doors with the latest offerings in technology.

"Every year the amount of transactions being handled electronically surpasses paper transactions," Martorana said. "You have to have the technology to serve these customers' needs. De novo banks also have a huge advantage because they don't have legacy systems."

New Jersey's de novo banks are seeing the same market environment that older community banks are finding, including business activity across all sectors and the opportunity to lend at a time when larger banks are pulling back from the mid-size and smaller business markets, the experts said.

"Businesses are going to the larger banks and they're being told no," Martorana said.

Simply put, de novo banks have money.

"De novos may be in an enviable position because most of them have more capital than is required and there might be the opportunity to acquire assets at a lower cost because of the capital base," Lenihan said.

Added Heath, "You don't have a seasoned portfolio of loans which over time have gotten worse because of loan devalue. You're decisions are fresh and based on fresh information."

It is not always smooth sailing for de novo banks, however. Despite starting with a balanced founding group, securing solid guidance and senior personnel and adhering to a well designed business plan, de novo banks sometimes fall prey to the pressures of needing to grow at a pace that will ensure survival.

McEwen identified a number of red flags that might warrant concern by regulators closely watching a de novo bank's growth and business practices, including reduced quality in quarterly filings; large variances and divergences

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Assemblyman Jack Connors, D-7.

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from the business plan; changes in directors or executive management; high risk lending and increasing delinquencies; weak loan and/or deposit growth; and new business lines and products that are inconsistent with the bank's existing profile.

Finally, when and if a de novo bank survives the baptism by fire, what becomes of it after five years — by definition the end of a de novo bank's life span?

"That's when you have to start to focus on what well-established banks must do to be successful," Heath said. "That's when you're competing toe-to-toe with everybody else."

Of course, what a de novo becomes depends to a large degree on what its founders intended, experts point out. Many if not most de novo banks eventually are either sold to or merged with other banks.

"It depends on what your mission is," said Lenihan. "Some de novos want to be Donald Trump — they want $5 billion, in which case five years doesn't cut it. The investors are looking for an endgame. They want to know they can cash out."

That is not always the case, however. Some de novo banks want to remain independent and continue growing, using the same philosophies that gave them an edge in the first place, Kenny offered.

"I've got first-, second- and third-generation investors, and they have no interest in selling the bank," he said.

Martorana agreed.

"You can still retain a lot of the employee empowerment," he said. "You are still a smaller community bank, still small enough to make decisions quickly."

And what becomes of the workhorses who led — and in some cases pulled — the de novo bank through its five-year ordeal?

"I like challenges," Lenihan, a community bank veteran said, "I like to go out and do things. I joined because I thought it was a unique opportunity. I thought I could apply my skills and make it a success."

Kenny has found his de novo experience more taxing.

"This is my first and since there is no intent to sell the bank, it will probably be my last," he said.

Heath agreed with both his peers.

"It's a very challenging job, but it's worth it," he said. "You have to try it at least once."