

BANKMARK 2007

# THE BASICS

FORMATION PROCESS THROUGH CHARTERING



# BANKS MAKING MONEY

IN 2006 : IV Q - FDIC

## Industry Earnings Remain Strong through the End of 2006

FDIC-insured institutions reported a total net income of \$35.7 billion in the fourth quarter of 2006. This was the lowest quarterly earnings total in 2006, but it was still more than the industry has earned in any quarter prior to 2006. Fourth-quarter net income was \$3.0 billion (9.3 percent) more than insured institutions reported in the last quarter of 2005 when large losses in credit-card portfolios hurt industry earnings. Fourth-quarter results were affected by accounting adjustments triggered by a few large corporate restructurings that occurred during the quarter; these adjustments had the effect of reducing a number of reported income and expense items. If not for these adjustments, industry net income probably would have set a new quarterly record, thanks to large one-time gains at a few big institutions. However, core earnings would have still been below the levels of the previous three quarters in 2006.

## One-Time Gains Boost Fourth-Quarter Earnings

Net interest income was \$178 million (0.2 percent) higher in the fourth quarter than a year earlier. This is the smallest year-over-year increase in quarterly net interest income in three years. Without the accounting impact of corporate restructurings, the underlying growth rate would have been closer to 3.3 percent. Similarly, the industry reported total noninterest income for the quarter of \$56.1 billion, or \$677 million (1.2 percent) more than it reported for the fourth quarter of 2005. Adjusted for the effect of the restructurings, the increase in noninterest income would have been approximately 13.7 percent. Among items that were not affected by the restructurings, sales of securities and other assets yielded net gains of \$624 million in the fourth quarter, while extraordinary items

contributed another \$2.1 billion to pretax earnings. This is the largest quarterly amount of extraordinary gains ever reported. Most of the gains came from the sale of retail branches and a trust operation between insured institutions. One negative factor in fourth-quarter results was higher expenses for bad loans. The fourth-quarter loan-loss provision of \$9.6 billion was \$923 million (10.6 percent) higher than in the fourth quarter of 2005, and was the largest quarterly loss provision for the industry in two and a half years. The average return on assets (ROA) for the fourth quarter was 1.21 percent, the same as in the fourth quarter of 2005. Year-over-year improvements in quarterly profitability were concentrated among the largest institutions. More than half of all institutions – 52.4 percent – reported lower ROAs in the fourth quarter compared to the fourth quarter of 2005. Three out of every four institutions reporting lower ROAs also reported lower net interest margins.

## Margins Decline at Small Institutions

About two out of every three insured institutions (64.4 percent) saw their net interest margins decline between the third and fourth quarters of 2006. The industry's average margin declined from 3.38 percent to 3.20 percent, based on reported results. Excluding the accounting impact of corporate restructurings, the industry's fourth-quarter margin would have been closer to 3.30 percent. In an environment of relatively stable interest rates and an inverted yield curve, insured institutions average funding costs rose more rapidly than their average asset yields. This development is especially problematic for smaller institutions. During 2006, insured institutions with assets less than \$1 billion obtained three-quarters of their net operating revenue (total noninterest income plus net interest income) from net interest income.

Larger institutions obtained only 57.1 percent of their net operating revenue from net interest income.

### Full-Year Earnings Set a New Record for Sixth Consecutive Year

For the full year, insured institutions earned \$145.7 billion, surpassing the record level of 2005 by \$11.8 billion (8.8 percent). The cumulative effect of accounting for mergers that took place during the year, as well as the restructurings in the fourth quarter, caused the underlying improvement in income in 2006 to be understated. If adjustments are made to industry earnings in 2005 and 2006 for the impact of purchase accounting for mergers, then the year-to-year improvement in profits is approximately 9.6 percent. The largest contribution to the earnings improvement in 2006 came from noninterest income, which was \$18.7 billion (8.4 percent) above the level of 2005. Large banks accounted for most of the increase in noninterest revenue, as trading income increased by \$5.1 billion (36.6 percent) and income from investment banking activities rose by \$2.0 billion (20.1 percent). Net interest income was \$11.7 billion (3.7 percent) higher in 2006, even though the average net interest margin declined from 3.52 percent to 3.31 percent, the lowest annual average since 1988. The impact of the margin erosion on net interest income was outweighed by strong growth in interest-earning assets, which increased by 8.8 percent during 2006. The improvement in full-year earnings was also aided by a decline in loan-loss provisions, which were \$414 million (1.4 percent) lower in 2006 than in 2005. Sales of securities and other assets produced \$2.8 billion (57.8 percent) less in gains during 2006 than in 2005. As in the previous three years, rising interest rates caused the market values of institutions' fixed-rate securities to decline, which contributed to the reduced gains. However, the lower securities gains in 2006 were offset by a \$2.4-billion increase in extraordinary gains. More than half of all insured institutions — 55.9 percent — reported higher net income in 2006 than in 2005, but only 46.3 percent of institutions reported higher full-year ROAs.

### Deposit Growth Sets a New Record

Total deposits increased by \$247.2 billion (3.3 percent) in the fourth quarter, easily eclipsing the previous record quarterly increase of \$200.9 billion in the fourth quarter of 2004. Deposits in foreign offices increased by \$90.2 billion (8.2 percent), while deposits in domestic offices grew by \$157.0 billion (2.4 percent).

Time deposits in domestic offices increased by \$30.0 billion (1.2 percent), the smallest quarterly increase in two and a half years. Other domestic interest-bearing deposits increased by \$70.4 billion (2.4 percent), and domestic noninterest-bearing deposits had a seasonal increase of \$56.6 billion (4.9 percent). The percentage of total assets that is funded by deposits, which hit an all-time low at the end of the third quarter, soared in the fourth quarter to 66 percent, its highest level since the first quarter of 2003. Nondeposit liabilities declined by \$162.8 billion (5.5 percent) during the fourth quarter.

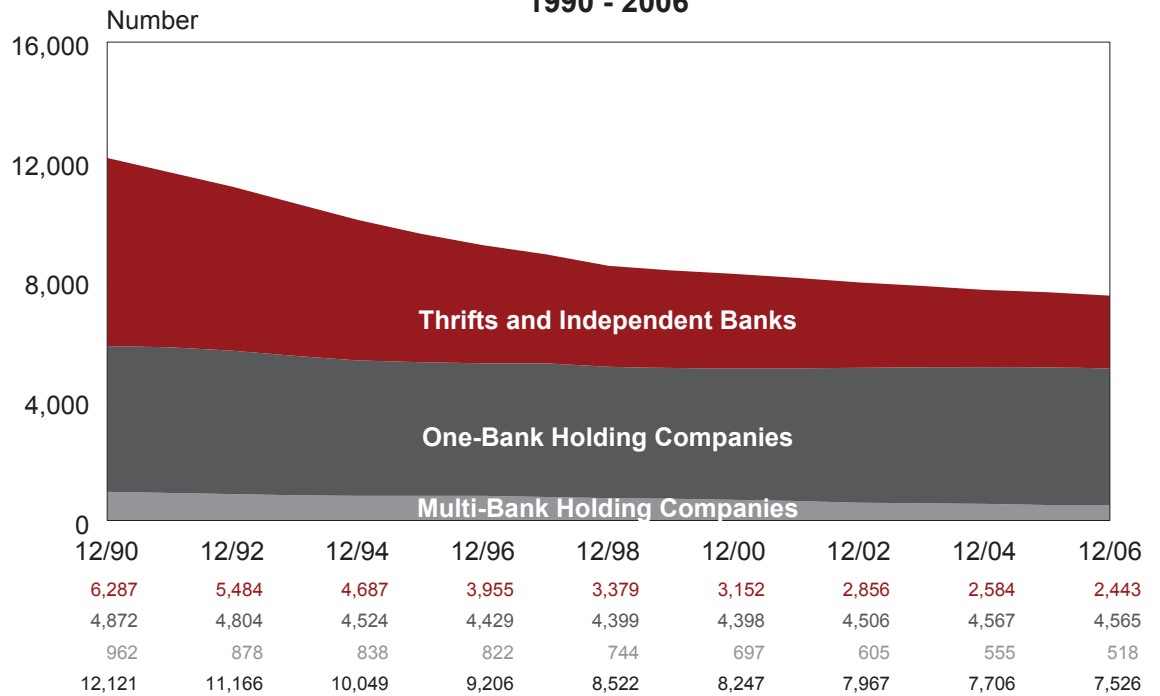
### No Insured Institutions Fail for Second Year in a Row

The number of institutions reporting financial results declined from 8,744 to 8,681 during the fourth quarter. There were 46 new charters added, while 108 charters were merged into other institutions. For the tenth consecutive quarter, no FDIC-insured institution failed. In 2006, there were 191 new charters added, the largest annual total since 2000. Mergers absorbed 342 charters during the year, the most in any year since 2001. During the fourth quarter, the number of institutions on the FDIC's "Problem List" increased from 47 to 50, and total assets of "problem" institutions increased from \$4.0 billion to \$8.3 billion. During the fourth quarter, four mutually-owned insured savings institutions with \$1.0 billion in assets converted to stock ownership. For the full year, 22 insured savings institutions with combined assets of \$11.8 billion converted from mutual to stock ownership. For the third year in a row, the industry added more than 50,000 full-time equivalent employees. Insured institutions reported more than 2.2 million employees in the fourth quarter, a 2.6-percent increase over a year earlier.

SOURCE: FDIC, QUARTERLY BANKING PROFILE,  
FOURTH QUARTER 2006

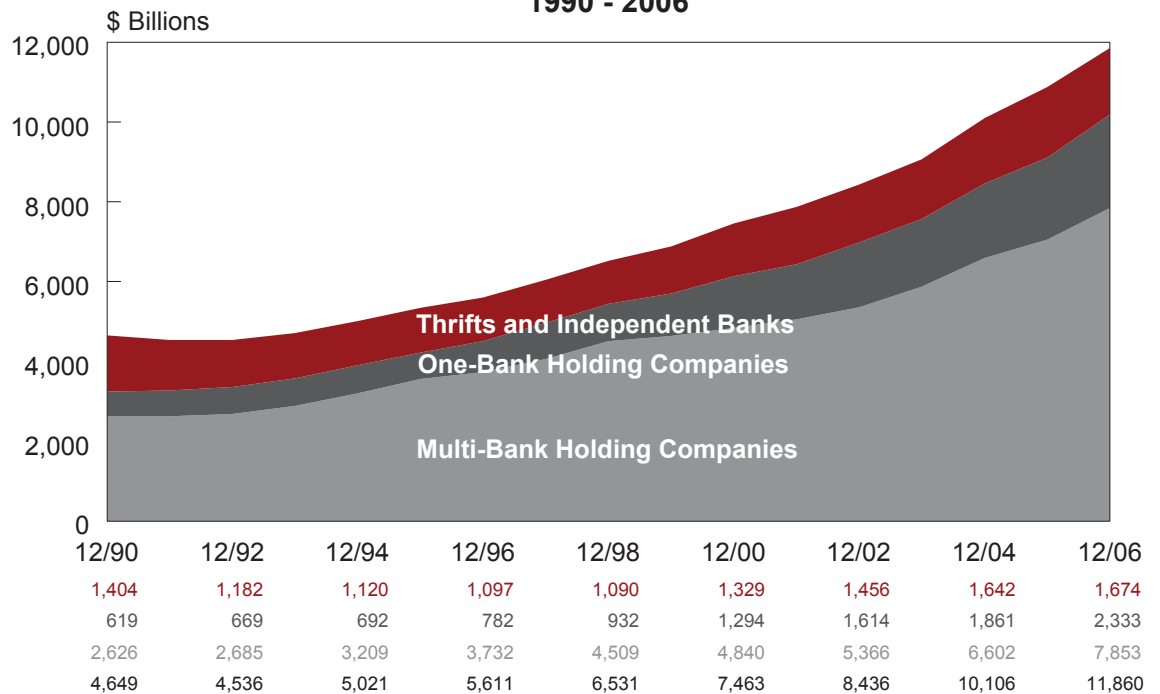
### Number of FDIC-Insured Banking Organizations

1990 - 2006



### Assets of FDIC-Insured Banking Organizations

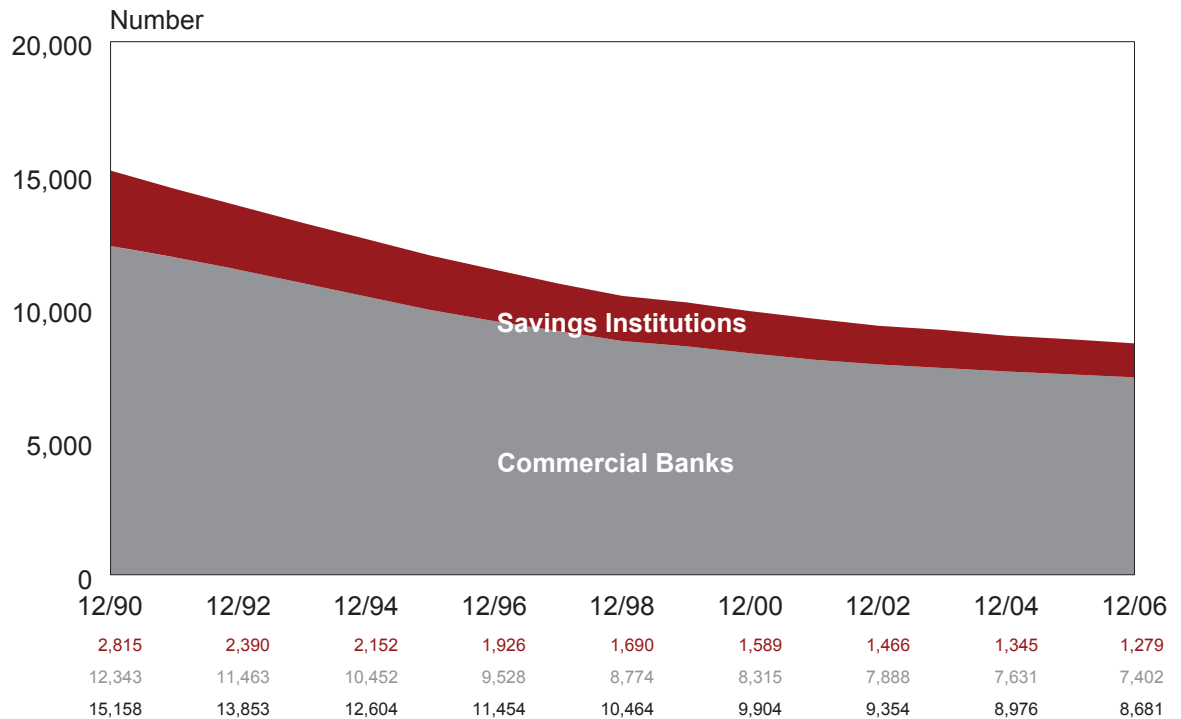
1990 - 2006



\* Includes thrifts owned by unitary thrift holding companies or multi-thrift holding companies.

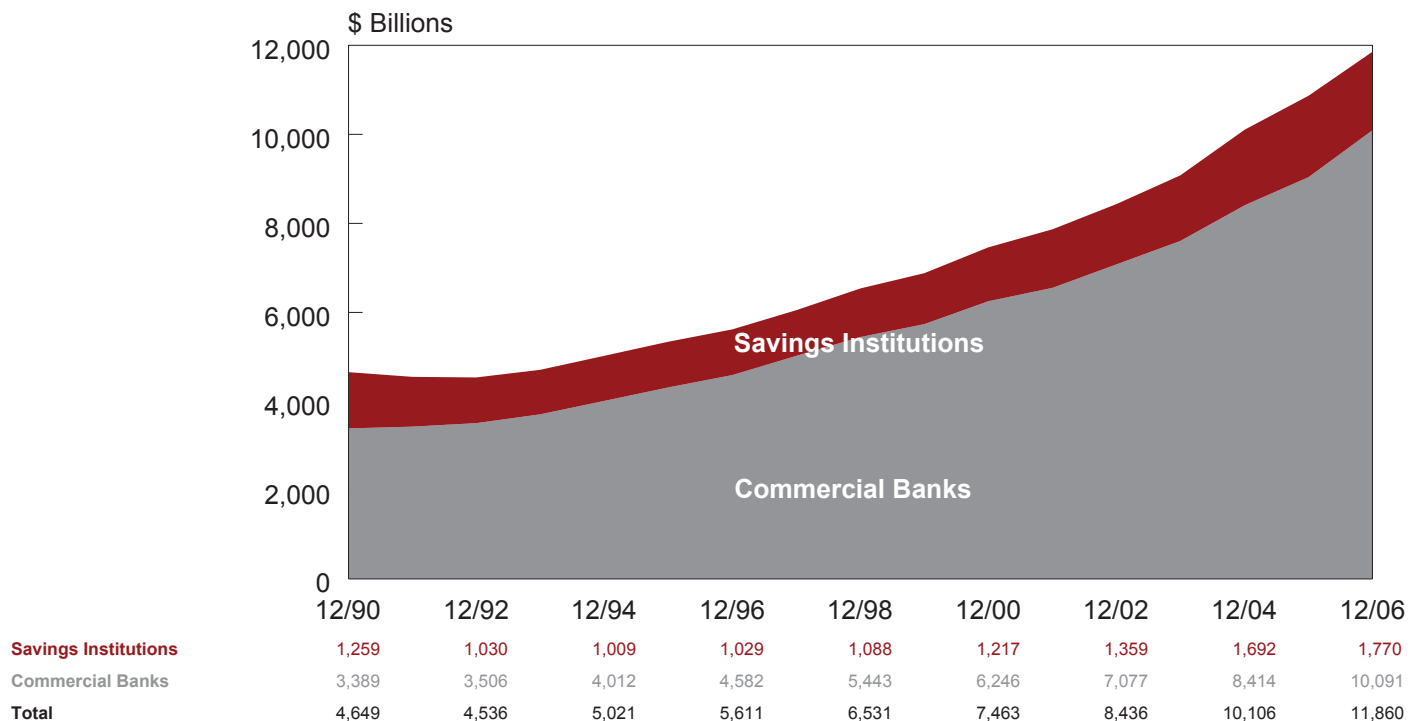
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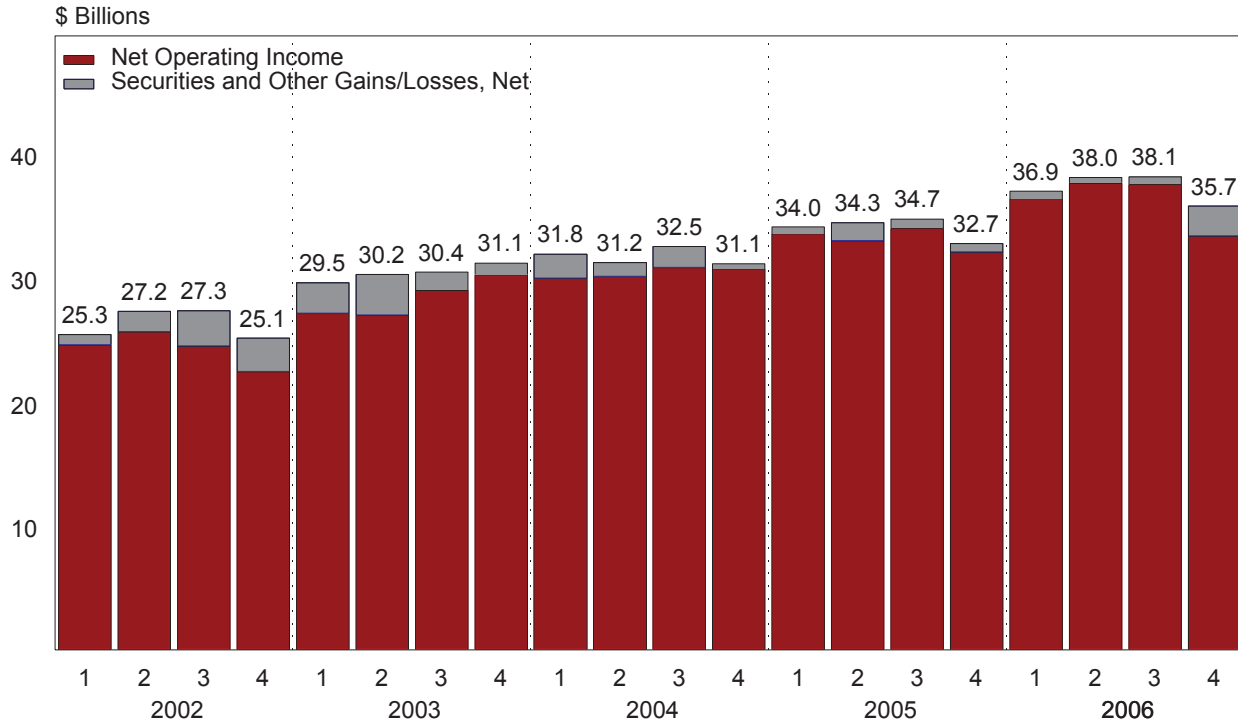
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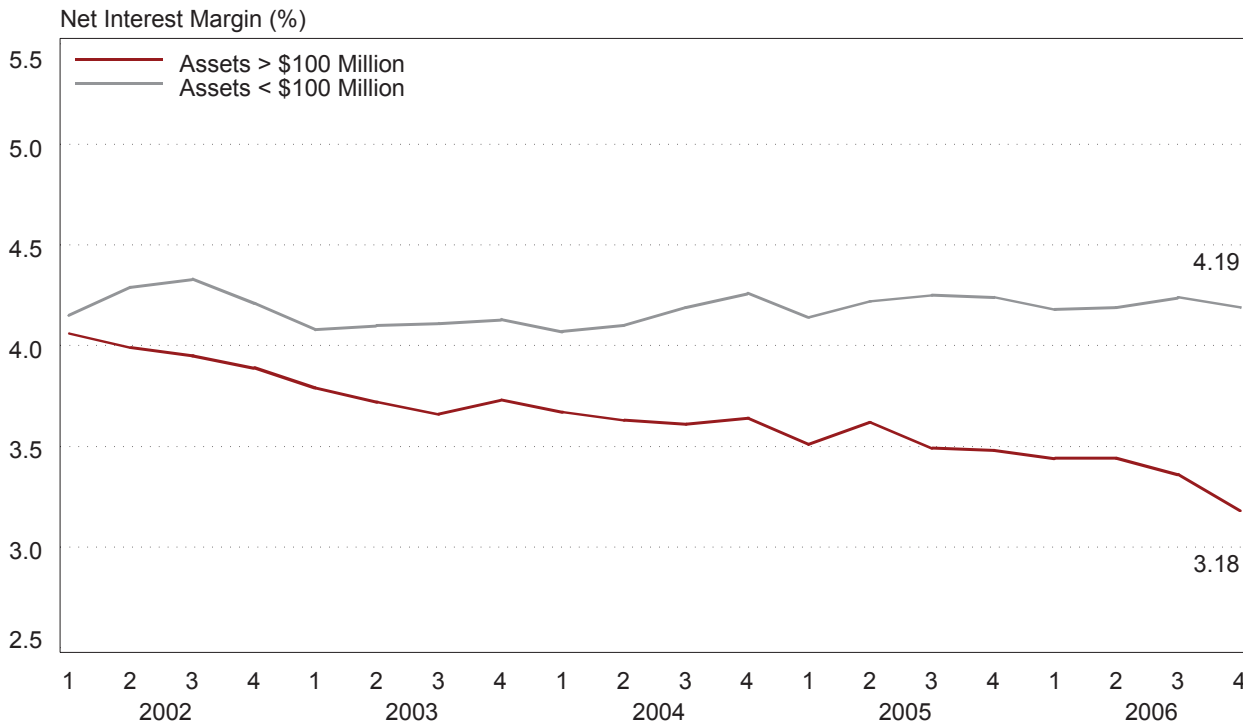
### Quarterly Net Income

2002 - 2006

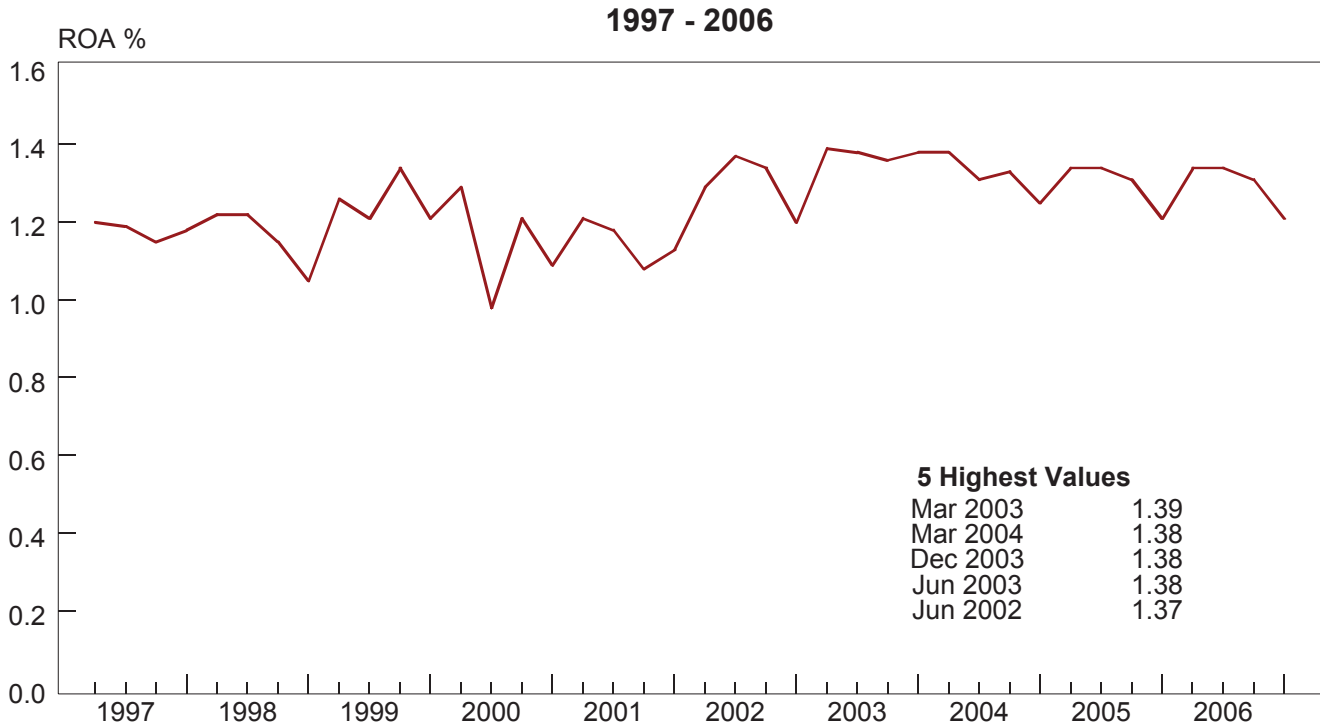


### Quarterly Net Interest Margins, Annualized

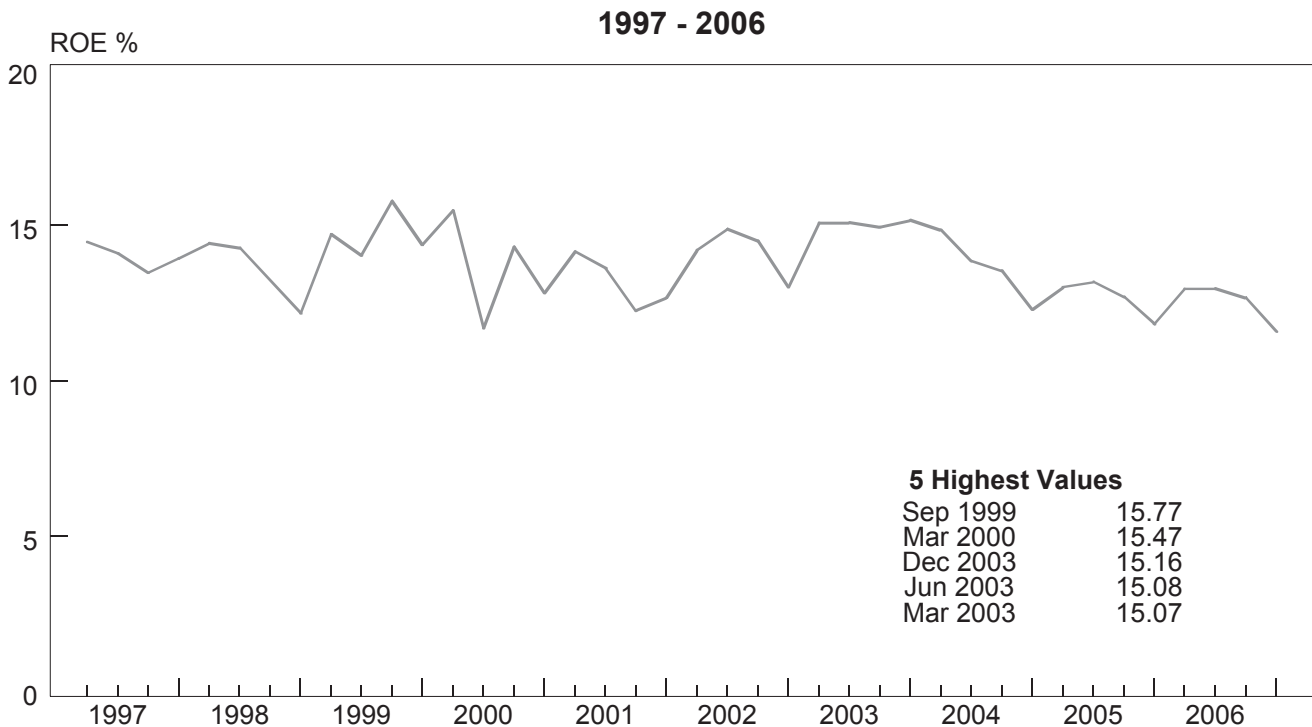
2002 - 2006



### Quarterly Return on Assets (ROA), Annualized



### Quarterly Return on Equity (ROE), Annualized





# FIVE PHASES OF DE NOVO FORMATION

BY CAREY RICHARDSON

Community banks strengthen the economy in two ways; they provide a forum where residents and businesses can receive service from a local bank with local values, and they create an investment opportunity for individuals and businesses that want to put their money in a place where it will bring a positive return, while at the same time supporting the community.

Generally speaking, people start community banks because they see a void such an institution can fill; i.e. the large bank down the street won't approve a small business loan it deems to be a risk, while the community bank on the corner may because that small business will create jobs and provide a service the community could use. It is a void such as this that drives many to establish a new community bank.

The process of opening a new bank is a complex one, involving strict regulations, extensive research, numerous contracts and documents, and time. Such a venture is a daunting task for those who have never opened a bank before, which is why advice from a consultant, lawyer, economist, and money-maker, who have successfully completed this process before, is often sought.

## 1. INTRODUCTION TO THE BANKING INDUSTRY

“Bank” is an all-encompassing term people use to refer to many different types of financial institutions, though what you refer to as “bank” may actually be a bank and a trust company, a savings bank, or a savings and loan.

### 1.1 What is a Bank?

Banks are privately-owned institutions whose primary function is to accept deposits and make loans. Banks are generally used by people and businesses to store money that gener-

ates interest for the depositor, and pay bills through checking accounts. Banks can be grouped into two general categories: commercial and community. Commercial banks focus on large corporations for their lending activity while community banks focus on the local community, granting loans for cars, houses, education, and small businesses.

### 1.2 How Banks Create Money

Banks lend out a portion of the deposits they collect, and keep the remainder as primary or secondary reserves, which are used to pay out to depositors. Primary reserves are cash; Secondary reserves are securities banks purchase, which may be sold to meet short-term cash needs. Federal law stipulates the percentage of deposits a bank must keep on reserve, either at the local Federal Reserve Bank or in its own vault. Any money a bank has on hand after it meets its reserve requirement is its excess reserves.

It's the excess reserves that create money, through what is known as the multiplier effect. In this effect deposits are split into two categories: reserves and loans. The required reserve amount from each deposit is stored in the bank, while the remainder is used to make loans to other customers. As those loans are spent the cycle begins again, with the recipient of the money keeping a percentage for their reserves, and loaning out the remainder. As money changes hands through deposits and loans the original deposit amount multiplies, thereby “creating” money. The size of the multiplier depends on the amount of money banks must keep on reserve, which can vary depending on stipulations made by the Federal Reserve.

### 1.3 How Banks Make Money

Though banks are critical for economic development, at their core they are privately-owned, for-profit institutions. Banks are generally owned by stockholders, whose investments form most of the bank's equity capital. At the end of

each fiscal year a bank pays some or all of its profits to its shareholders in the form of dividends, which stockholders may choose to reinvest in the bank. Profits retained by the bank are added to the bank's capital.

## BANKS EARN MONEY IN THREE WAYS:

- Charging a higher interest rate on loans they make than the interest rate they pay for deposits.
- Generating interest on the securities they hold.
- Charging for customer service functions such as checking accounts, overdraft protection, financial counseling, loan servicing, and sales of other financial products such as insurance and mutual funds.

On average banks earn just over 1% of their assets (loans and securities) every year, a figure commonly referred to as a bank's "return on assets," or ROA.

## 2. INTRODUCTION TO COMMUNITY (DE NOVO) BANKING

Community banks promote competition and provide quality services within the community, a service that isn't always available at commercial institutions, which don't have local decision makers. Chartering a new community bank provides the opportunity for local investors to profit from the high-quality services offered by a community bank, and strengthens the local economy through loans to consumers. These scenarios aren't new; they are a natural part of the cycle of community banking.

There is a predictability to the ebb and flow of community bank activity in the United States. Every seven to ten years, since the end of World War II, we have witnessed a resurgence in new bank applications submitted, and charters granted. This is usually followed by a period during which mergers and acquisitions have taken their toll.

In the aggressive '80s hundreds of new community banks were chartered, plus a number of unsuccessful attempts to organize. Of those opened, some have prospered, some have failed, and many have merged or were acquired, leaving a gap in the community banking industry. So here it is 2007 and again many business and civic leaders in communities throughout the state are asking themselves the same series of questions: "what happened to our local bank?" ... "why can't I get the service I need and deserve?" ... "the banks that are left may be bigger and more efficient, but how does that help us?" ... "whatever happened to local personalized service?" which indicates that the market is right for a new commu-

nity bank; a forum where residents and businesses alike can receive service from a local bank with local values.

However, the desire for a local institution with local decision-makers does not equal a profitable bank. Several factors, listed below, explain why community banking is successful in the United States.

1. Selectively investing in community banks over time has rewarded many investors. Growth in earnings and the accumulation of assets are the primary considerations for organizing or investing in a new bank. Investors who buy stock in a new business venture generally make their decision after reviewing other success stories within the same industry, and those that have profited from purchasing bank stock in the past are likely to do so again.

2. The large National and Super Regional banks operating in the United States typically focus their attention on major corporations for lending activity while gathering deposits via an impersonal electronic mass marketing process. Community banks focus on small business and niche marketing, and generally take a more personalized route in the services they offer.

3. The absence of layered management and committee structures in the community bank allows for rapid decision-making, flexibility in the face of changing market conditions, and a greater responsiveness to the customer's needs.

4. Specialization and niche marketing by a community bank can create lucrative opportunities in market areas that are neglected or not effectively served by larger banks.

5. Few community banks must support large, costly, and outmoded branch networks.

6. The Board of Directors, when composed of influential members of the community, make meaningful contributions to the bank by tapping into the community for loan and deposit business. They also influence operating policies specific to that market.

7. Individual investors tend to support the value of their investment by directing business to the bank.

8. Stock options to management and staff, and Employee Stock Ownership Programs, provide a tremendous incentive for the employees to perform with shareholders' interests in mind.

9. Community banks, collectively, hold less than 15% of the total of America's deposit base, leaving ample room and need for growth.

10. Deregulation has revolutionized the banking industry, giving community banks the opportunity to compete on a more level playing field, and develop new profit areas

that were not previously available to them. There are now more options open to deploy their resources, offering more products and services in order to cross sell to customers.

11. Technology has helped create many new banking products, giving community banks the ability to expand their asset base faster and less expensively than with the old-fashioned, brick-and-mortar branch system. This technology has become cheaper and more readily available, even to smaller community banks.

12. A pattern has emerged in the community banking industry; successful local banks are being acquired by larger institutions. These mergers are often very favorable to the bank's shareholders, which is why potential investors should not overlook a potential exit bonus. Further, as banks are acquired or merged, the cycle is ready to begin again.

Over the past several years, many astute and successful Americans have been involved in community banks as organizers, Directors, Founders, or investors. Many of these banks have found their niche in the local market and, as a result, their shareholders enjoy annualized returns between 12% and 15%. Community banks have demonstrated they can effectively compete against large banks by delivering quality service to selected segments of their local market. Well-capitalized community banks that are well-managed and strategically located will continue to prosper. In doing so they can continue to be attractive investments, and lucrative ventures for the local economy.

### 3. HOW TO START A BANK

The process of opening a bank begins when a group of people come together to build a common vision for a proposed bank. These individuals, who usually number between three and five, can be bankers themselves, or entrepreneurs with little banking experience but the resources and financial wherewithal to set things in motion.

There is usually always one banker, or someone with knowledge of the banking industry, in the initial group. This is not a requirement, however, it is usually this individual who sets things in motion, because they feel a new bank would be a beneficial addition to the area, as well as a sound investment.

Determining whether any given area can support a new bank requires pre-planning; you can't just walk into a lending institution with a business plan and expect to be granted a loan, you must have explicit plans for operating and marketing your financial institution, which must be approved by either a state or local regulatory agency. However, a regulatory agency will only grant approval if you can demonstrate that your market can support a new community bank. Demographic research will help you determine the feasibility of a new bank in your market area. General indicators include changes in unemployment

rates, population growth, and recent mergers or acquisitions of other financial institutions.

If you want to start a new bank or thrift to get even because your favorite hometown locally owned and controlled bank or thrift was bought out by one of the big, bad money centers, you might want to spend the first several thousand dollars on a good shrink. On the other hand, if recent mergers and acquisitions within your community have led to inferior banking service, dissatisfaction by consumers and businesses, and a significant decline in economic development and financial leadership - there is probably room in your community for a new bank or thrift that can provide quality products and services, plus make beaucoup bucks for your investors.

Once you have determined the feasibility for a new community bank in your area, you are ready for the first phase in the de novo process.

#### 3.1 Five Phases for Building a Bank

There are five phases for opening a new financial institution, which take at least seven months to complete, but typically take 15-18 months. These phases are described in detail below.

##### 3.1.1 Phase 1: Pre-Filing

In the first phase the organizing group is formed, and comes together in preparation for an initial meeting with the Regulators. The organizing group is composed of organizers, directors, and bank management, who develop a vision for a community bank and work together to implement that vision. The pre-filing phase can take anywhere from 30 days to several months, depending on how fast the group comes together.

##### 3.1.1.1 Selecting the Organizing Group

Selecting directors and organizers is a critical task for a new bank, as these individuals will determine the eventual success or failure of your venture. Ideally, your organizing group will be composed of a minimum of six individuals who have both credibility within their local community, and a diverse range of business experience and community contacts. These individuals should also be capable of holding a meaningful, vested financial interest in the new bank (cumulative 25-30%).

The number of directors/organizers you must have varies from state to state. In Florida, for example, you must have at least five, and there is no maximum number. In all states, these partners have to put up money as an initial offering that shows their level of commitment, and help get the bank going.

Candidates for the organizing group can be found almost anywhere, but the best approach is to look at your market area. If you plan to inhabit a rapidly growing urban area you might want to approach a well-known contractor. If the area

has a large Mexican population you may want to approach a spokesperson for that community. Doctors, lawyers, financial planners, even retired persons make good candidates for the initial organizing group, provided they meet with the requirements outlined for them.

Although the initial group should be one that has similar expectations and commitment to the project, the manner with which you assemble your initial group is not as important as what you do together. Once assembled, the initial group identifies what type of bank they want to open, and what services they want to provide, before actively seeking out others to participate.

### 3.1.1.2 Selecting the Management Team

Once the organizing group has determined what type of bank they want to be they should begin to identify the management team including, a chief executive officer (who usually has to have past experience running a bank), President, and other executives. These are the individuals who will guide both employees and the board of directors through the banking industry in an effort to help the bank grow and prosper. These individuals should have extensive banking experience, and significant experience working within groups that initiate and implement policies. Solid knowledge of the local market and banking industry are also critical.

The regulators (the governing body that has final approval on whether or not your application is granted) place a great deal of emphasis on having experienced, competent, bankers for this role. Such emphasis is placed on the management team because it is their actions that will determine whether shareholders will see a gain or a loss on their investment. To protect the shareholders regulators need to be sure that the management team is capable not only of opening a bank, but successfully operating it, before they will grant their approval.

The greatest asset any management team can have to ensure approval with the regulators is their level of experience. Similarly, the integrity, past business histories and credit histories of these people will greatly affect the acceptance or denial of the bank's charter. The important thing is to carefully select these partners and make sure they are team players, have the experience and know-how to help you make the bank work, and can withstand (both professionally and personally) the close scrutiny of the regulatory investigation.

### 3.1.2 Phase Two: Application

The application process includes gathering information for, reviewing, and submitting an FDIC application, and a state or national banking application, depending on the type of charter you select. Both applications must include at minimum a tentative location for the proposed bank,

and a list of potential directors. The application phase takes approximately 4-6 months to complete.

#### 3.1.2.1 Selecting Your Charter

Prior to submitting your application you must first consider what type of charter best suits your business plan. Charters authorize the organization of a financial institution by either a state or federal agency, which govern the manner in which that institution is regulated and/or operated. Such regulation is often performed through on-site examinations to make sure the bank's financial condition is good, and that the bank is complying with banking laws.

There are two types of charters you can apply for when opening a new bank, State or Federal, each of which requires its own application. There is no requirement that a de novo institution choose one or the other; the decision is made by the organizing group according to their own preferences. State charters and federal charters typically do not differ too much in the way the bank conducts business. They do, however, differ in other areas.

Although State charters vary from one state to the next, each state has a regulatory board that governs chartered banks, and sets the policies those banks must abide by. Some states may, in addition to their own regulations, require that you are a member of and comply with regulations set forth by the FDIC, the Federal Reserve, or both.

Under a Federal charter you are governed by the Office of the Comptroller of the Currency (OCC), and you must be a member of and comply with regulations set by both the FDIC and Federal Reserve. OCC regulations do not vary from state to state, rather, they are equally and similarly enforced throughout the US, as are the regulations imposed by the FDIC and Federal Reserve.

There are both pros and cons for selecting a State or an Federal charter. For example, lending limits vary by state, and some states actually have higher lending limits than what would be permitted with the OCC. Further, some state charters may require you to be a member of the FDIC while others may not. Florida is one such example, where state chartered banks are not required to be members of the FDIC, but federally chartered banks are.

The key to selecting the best charter really comes down to preference and timing. At any given point in time the State may offer more user-friendly services than the OCC or vice versa. Similarly, the OCC could have competitive lending limits one year and poor ones the next. Some people feel state charters offer an easier application process, while others feel the consistency of a Federal charter between states is advantageous.

There is no right or wrong choice when it comes to choosing a regulatory authority with which to apply for a charter. Careful analysis of the charter application and regulatory restrictions can help you weigh the pros and cons to make an accurate decision. Keep in mind, however, that your business plan will play a large role in this decision, and, in some cases, may dictate what type of charter you choose.

### 3.1.2.2 Completing the Application

Once you have chosen a chartering agency you can begin to fill out the charter application and submit it (along with a lot of other information) to the state's board of finance and banking ~ or, if you're applying for a federal charter, you'll send it to the Office of the Comptroller of the Currency. There will also be a filing fee, approximately \$15,000 in most states, which needs to be submitted with the application.

Before you actually file your application, it is recommended that you set up a pre-filing meeting with your selected regulatory agency. This will help make sure that you have all of the information you need to file. Usually, the biggest delays come from incomplete background and/or financial information.

### 3.1.3 Phase Three: Regulatory Review

In this phase bank regulators initiate their own market analysis, including interviews of organizers, and provide an analysis of and recommendations for the proposed project. The organizing group prepares responses to the Regulators' questions, and provides any additional information requested. Once this process is complete, the bank receives its approval.

Once your application is deemed complete, a decision from the Regulators will be given within 180 days. If your charter is granted, you will usually have up to one year to open your bank. In all states, you are required to apply for deposit insurance with the FDIC before you can accept deposits from the public.

#### 3.1.3.1 Organizer Interviews

Whether you choose a state or Federal charter, your application must include a complete disclosure of a proposed Director's background, which the Regulators will verify during their review of your application. Regulators will also verify that all applications include a statement of authenticity or truthfulness from the applicant, as well as the applicant's signature.

#### 3.1.3.2 Responding to Regulatory Recommendations

In the event the Regulators dislike part of your application, you will receive documentation from them about what they disliked, and how they advise you to remedy it. Your consultant and/or economist can interpret Regulatory com-

ments, and re-write the application to reflect those suggested changes. Once changes have been made the application is submitted again. It is not uncommon for this process to occur one or more times during the application phase, though a competent consultant/economist will reduce the likelihood of the need to submit multiple applications.

### 3.1.4 Phase Four: Capital Pre-Launch

The action plan for selling bank stock is developed in this phase, while management finalizes all details for opening the bank's doors, including necessary equipment, procedures, forms, supplies, marketing materials, and staffing. At the end of this phase, preliminary permission to open the bank is offered following a final inspection. This phase typically takes between 2 - 3 months to complete, depending on the rate at which you raise your capital.

#### 3.1.4.1 Developing the Capital Acquisition Plan

##### 3.1.4.1.1 How Much Will You Have to Sell?

The amount of stock you need to sell, to generate your startup capital, depends largely on your business plan (what types of services you want to offer and what funds you need to adequately provide those services, such as loans, salaries, etc.) and your market (the population, and how many shares that population can reasonably be expected to purchase). The key to this dilemma is accurate budgeting and demographic research.

Careful budgeting will help prevent the Organizers from having to cough up more money for unexpected expenses, but it is also an important stepping-stone towards identifying how much capital you need to open your bank. You don't want raise 14 million dollars in capital only to realize that since you spent \$800,000 on pre-opening costs you only have \$13.2 million to work with. If your goal is to have 14 million to open then you have to net that amount, which means you actually need to raise \$14.8 million. Budgeting will help you achieve your capitalization goals despite unexpected expenses that may arise.

Demographic research of your target market is important because some of those individuals may actually be the ones purchasing shares in your bank, and you need to know how much stock they can afford and at what price. Additionally, you need to determine what services they look for, and what it will cost you to provide those services, if you want to adequately meet their needs. Having a clear idea of what people want and what you can provide will help you determine what monetary resources you need to support your business plan and open the bank.

Most people who have been through the de novo process before will tell you that they're scared to open a bank with less than ten million, however, the actual amount of capital

you will need will be determined by your marketplace and business plan. Your experts such as economists, consultants or lawyers should be consulted before making a final decision, because they should have specific knowledge of the banking industry in your area.

### 3.1.4.1.2 How Many Shareholders Will You Need?

Once you've determined how much capital your de novo bank will require, you should begin to consider how many shareholders you would like, or are permitted to have. A good rule of thumb is that the more shareholders you have, the more potential customers you have. People who invest in your bank by purchasing stock have a financial stake in the success of the institution, and, if they are smart investors, will do what they can to protect and grow their investment.

There are two ways shareholders can ensure the bank's success; opening their own accounts, and referring their friends. Therefore, it stands to reason that if you have three-hundred shareholders you will have approximately three hundred customers. Further, if each of those customers tells two or more people about the bank, your depositor base can grow exponentially.

One factor that may affect the number of shareholders you have is the amount of money each invests. If you plan to raise ten million and each investor puts up only five thousand, you could theoretically end up with two million investors. Conversely, if each investor puts in five-hundred thousand you could end up with only twenty investors. It is for this reason that most proposed banks have a minimum investment level of between two and five thousand dollars, and a maximum investment level of between two-hundred fifty and three-hundred thousand dollars. These parameters help control the number of shareholders, and play an important role in anti-gorilla management.

As with any other organization that lets the public invest, any shareholder owning more than fifty percent of the bank's stock can have the ultimate decision when it comes to mergers, acquisitions, and offers to sell. Limiting the amount of purchases prevents any one shareholder from having that ability, and helps the bank remain in the hands of the community, where it was intended to belong. Limitations on stock purchased should apply to investors, directors, and management alike if these anti-gorilla measures are to be adequately enforced.

If your institution votes to implement such restrictions on stock purchases, the minimum and maximum guidelines are yours to determine. However, before a decision is made you should consider the demographic research to identify a reasonable minimum investment level for that area, and a maximum investment level that places shareholders far below any benchmarks that would give them control of the majority of the stock.

### 3.1.4.2 Finalizing the Operating Details

#### 3.1.4.2.1 What Needs to be Accounted For?

In this phase the project has been granted permission to sell stock, and is authorized to accept investments. The organizers and senior management actively engage members of the community to invest in the bank through a series of community meetings designed to educate the community on the new bank and the investment opportunity it represents. This phase can take anywhere from 3 months to one year, even longer if the group seeks an extension to sell stock after the initial subscription period has expired.

### 3.1.5 Final Phase: Post Conditional Approval

Once the operations have been finalized and the capital has been raised, the Regulators will conduct a final field interview to ensure the bank is ready to accept customers. Upon the passing of that test the bank is granted a charter and can open for business.

#### NOTES:

- (1) Some sections of the FDIC application can be prepared concurrently with State or OCC documents
- (2) A site for the facility must be identified and details completed before the FDIC will accept the application for review
- (3) "Responsible agency" can be the State Banking Department, or the Office of the Comptroller of Currency and the FDIC

## Appendix A

### Pre-Planning Factors to Consider

Should you start a new community banking institution in your town? The answer is not easy. You need to research whether there is a need for a new bank. If you build it - they may not come. Examine various elements to determine whether a need is evident:

1. Has there been more than one merger or acquisition in the market recently?
2. How many local banks or thrifts still remain within the community?
3. Have the local bank personnel been eliminated from the merged financial institutions?
4. Have new banks or thrifts moved into the market with de novo branches to fill a void?
5. Have banks had their names changed, and are their policies now being directed from outside your community or state?
6. Is the banking market growing, or have deposits remained relatively flat so that growth is reflected only by Federal Home Loan Bank advances?
7. Are banks and branches operating profitably within the market, or are the available institutions cutting each other's competitive throats for new customers?
8. Are those within your banking market (i.e., businesses and consumers) unhappy with the current banking environment? Just because there has been a bank merger does not mean that there is dissatisfaction - are you hearing minor gripes or a groundswell of opposition?
9. Do you have the personnel available to start a new community bank that will be accepted by the population and thus make it a profitable operation?
10. Can you raise the money from the local market in order to start the new bank?  
Do you need to go into the national market to raise capital, bringing in professional investors who will care little about your community but a lot about their financial return?

## The Chartering Process

(Margin of error: 60-90 days)

### First 4 months:

- Organizer Group/C.E.O. executes Pre-Inc. & Bankmark Agreements, retains Legal Counsel
- Sub-Committees begin work (Site/Facilities, Personnel/Compensation, Technology, Mktg.)
- Local/regional econ. Articles, demographic studies, community ltrs. of support, collected)
- Letter(s) of intent are solidified for site(s)
- Primary Regulator choice made
- Organizer group closed out
- “Red Folder” meeting held to begin gathering necessary Fin./Biog Info. from Organizers
- Application construction begins (Mgmt. & Charter Capital Services/Bankmark)
- Organizers are interviewed/fingerprinted as Biog./Fin. pkg’s are finalized

### Months 5-9:

- Compensation Committee structures Employment Agreements for/with Exec. Mgm’t
- Stock Option / Warrant Plans for Insiders (& Public) are developed w/ legal counsel
- Art’s. of Incorporation, By-Laws, etc. executed
- Correspondent Bank (for Organization Loan, Offering proceeds escrow, etc.) selected
- Chief Financial Officer comes aboard
- Policies (Loan, CRA, Funds Mgm’t., Audit, etc.) developed/approved by Mgmt./Board
- Vendor Selections: Core & Item Processing; Internet Provider; Online Bkng.; Fin. auditors;
- P&C/D&O insurance carriers; financial printer, etc.
- Pre-Filing Meeting w/ Regulators
- Final Application exhibits collected (e.g., Hist. Presv. clearance, all contracts/legal doc’s.)
- Draft Prospectus/Subscription agreement/Other Offering materials prepared
- Application completed & submitted, Legal Notice of Application Filing published

### Months 10-13: — Bank is “Proposed”

- Regulatory Review Period (Background checks completed, Field Visits occur, Exec. Mgm’t. responds to add’l. info. requests, etc.)
- Finalize Offering & Stock Marketing materials for printing

### Months 14-15: — Bank is “In Organization”

- Permission to Organize (i.e., secure capital) granted
- Offering & Stock Marketing materials printed
- Capitalization process (30-70 stock sale meetings)
- Prep. for opening (arrange for installation of systems, training, supply acquisition, etc.)

### Month 16 — Bank is now “Chartered”

- Charter Granted
- Notice of proposed opening day sent to regulatory authorities
- Pre-Opening (Regulatory) Site Examination
- System(s) Installation, personnel training, etc.
- First Board/Shareholders Meeting(s) held //stock cert’s, warrants, etc. issued

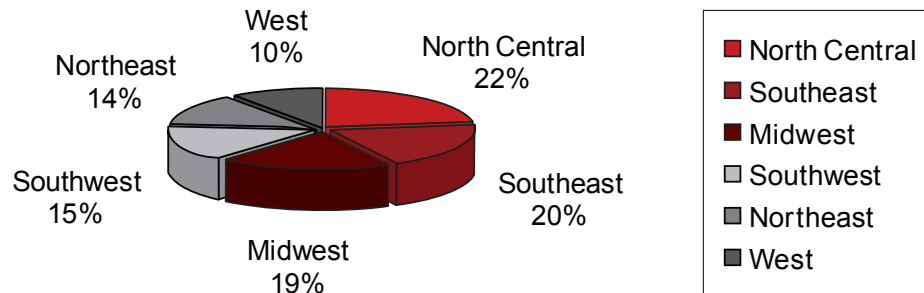
### Month 17 — Bank is “OPEN”

PLEASE NOTE – this schedule is applicable only to those groups who maintain monthly meetings with a Bankmark representative to review the status of the project and identify critical tasks and their deadlines.

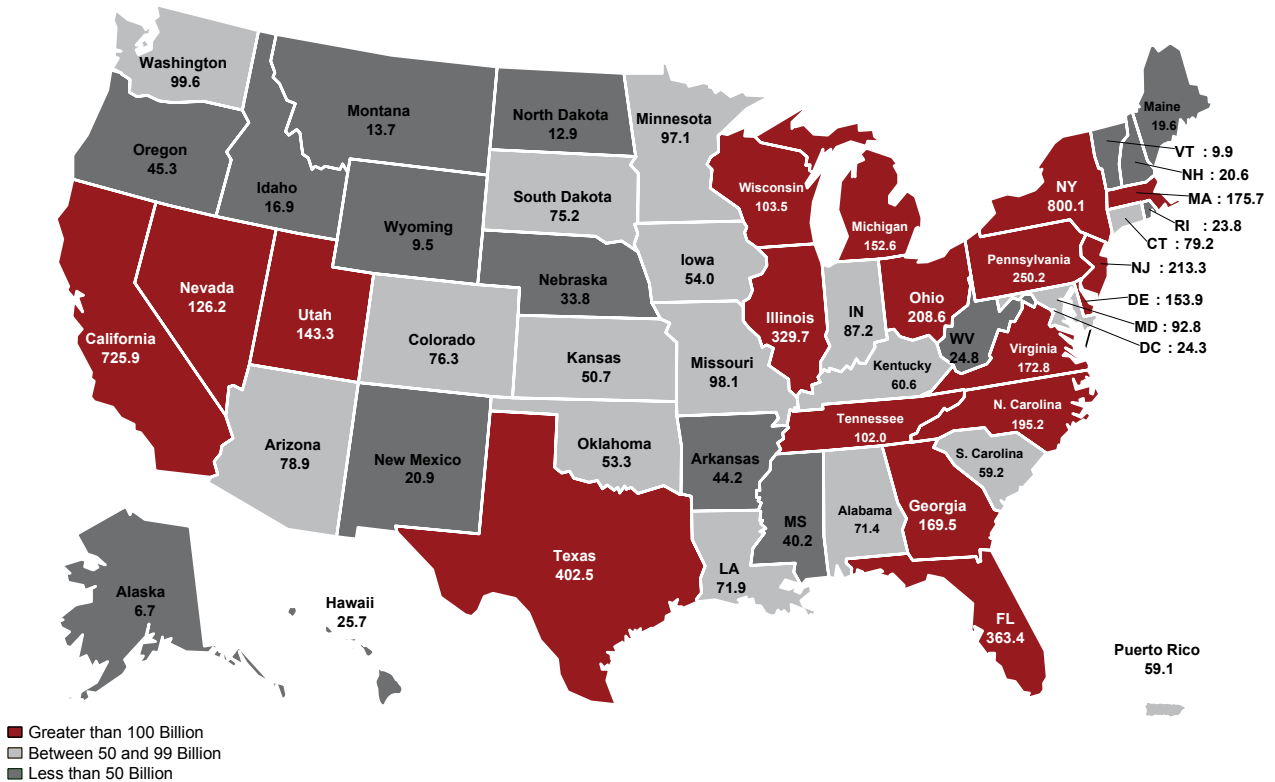


# DE NOVO BANKS QUICK LOOK

## Distribution of Community Banks by Region



## Deposits of FDIC- Insured Institutions By Office Location June 30, 2006 (\$ Billions)



## NUMBER OF NEW COMMUNITY BANKS GREW 30% IN 2006

March 2007

Nearly 30 percent more new de novo banks opened their doors in 2006 than did two years ago and 75 percent more de novos were formed in 2006 than in 2002, according to data from Federal Deposit Insurance Corp. and Wolters Kluwer Financial Services.

Several factors have contributed to the recent growth of new community banks, according to John Bryant, evp of banking for Wolters Kluwer Financial Services. The company has provided regulatory compliance solutions to 277, or more than 64 percent

of the 431 new banks formed in the past three years. “By working with approximately two-thirds of these newly created banks, we’ve found they are addressing very specific and targeted needs in their communities,” said Bryant. “The banking professionals identifying and satisfying these needs are typically motivated by an entrepreneurial spirit and recognize a new bank as a great business opportunity. And often times, they are former owners or employees of a merged or acquired bank that have chosen to strike out on their own rather than staying on or retiring.”

## Percentage of Banks UP. How to Get the Key to the Kingdom.

Banks profits are “the best in living memory for America’s Commercial banks...banks have been growing fast around the world...but nowhere does the industry seem more triumphant than in the United States. Last year American banks declared a fifth straight year of record earnings. Their return on equity has been at a 60-year high.”

-The Economist. Vol. 379 no. 8478.  
May 20th 2006. America’s Banking Boom.

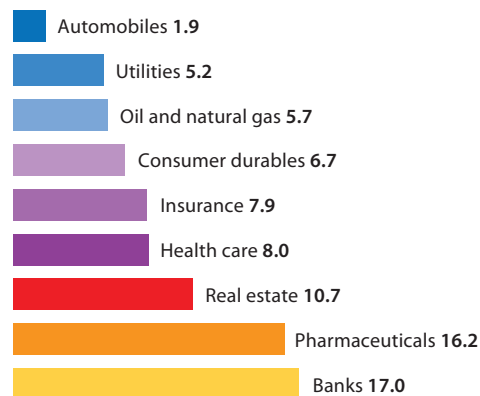
Number of New  
Community Banks  
Grew 30% in 2006



### Banks vs Other Industries

#### Profit Margins

Industry earnings from July 2000 to July 2005  
(Cents per \$1 of sales)



Source: USA Today 11/15/05



