5 PHASES OF DE NOVO FORMATION

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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 your Bishop hopes to fill by establishing 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.

Bankmark is a consulting firm that specializes in opening community banks. We have an established network of law firms, economists, accountants, and market-makers as part of our community bank development team, whose combined knowledge and expertise in this field have resulted in the successful opening of more than 117 community banks over the past 17 years. We have been asked to share our knowledge with you, to help familiarize you with the basics of forming a new bank so that you are comfortable in your knowledge of what this process involves, and how you can participate.

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 generates 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.

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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 2003 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 community bank; a forum where residents and business 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. A detailed list of indicators can be found in Appendix A.

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 typically take at least seven months to complete, but may take longer in some cases. A timeline of the phases is included in Appendix B, though 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 takes approximately 15 – 30 days.

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, while in X you must have X. 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. The required offering amounts vary by state, ranging anywhere from 10 – 25% of the total capital needed to start the bank.

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.

Additional factors to consider when choosing directors include:

- **Proven track record:** All proposed directors should have a record of their successes.

- **Reputation for ethical financial success:** All proposed directors should have achieved financial success legally and without question as to their methods.

- **Impeccable character:** All proposed directors should have the highest level of integrity and honesty. They should have sound business practices and contacts. It should be well-known among their peers that they have high moral values, both professionally and socially.

- **Fundraising ability:** All proposed directors should be capable of assisting to generate funds to support their cause.

- **Separate spheres of influences to those already represented:** For the purpose of fundraising, it is important that all proposed directors have their own circle of friends to bring into the shareholder family. Think of it in terms of generations; the first generation has a direct relationship to the director; the second generation has a direct relationship to the director's first generation and so on. As the generations expand outward the likelihood that they will overlap decreases, provided the first generation doesn't have a direct relationship to two directors. Conversely, if the first generation has a relationship with two or more directors then the outward expansion of each generation will overlap, resulting in a smaller number of potential shareholders.

- **Financial stability to incur project costs / overruns:** The process of opening a bank is one that requires a significant amount of money with which to get started, mainly for paying consultants, employees, application and site fees, and vendors. Typically, the management and directors supply the funds necessary to set things in motion, and must purchase a minimum amount of shares on top of that. Although it is possible to get loans to assist with such expenses both management and the directors must first qualify for such loans, which requires that they have adequate funds of their own.

- **A broad network of business and personal contacts:** In many ways this goes hand in hand with having separate spheres of influence. The larger the number of first generation contacts, the larger outward expansion can be expected, resulting in a greater number of potential shareholders.

- **An appreciation of the need for a new bank and what that bank should accomplish:** All proposed directors should share the initial organizing groups' vision for the bank, so that the group can cohesively work towards those goals.

- **Individual success in a wide range of fields with a broad range of experience:** If all your directors are doctors then the Board of Directors as a whole will have difficulty anticipating problems in the legal field, generating funds from the financial field or responding to economic changes in the technology field. By having directors in a wide range of fields you have a larger "area of expertise" to help you respond quickly to changes, gain profitability, and avoid risks.

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.

Becoming part of the organizing group may be something you are interested in, which we encourage you to explore however, please keep in mind that starting a new bank or thrift is not a left-wing, Utopian endeavor - it is the starting of a new financial institution for the express purpose of providing quality products and services and the furnishing of financial leadership that will result in significant rates of return on the investments of the incorporators. Further, you must be committed to the reason for the chartering of the financial institution within your community, rather than simply focusing on the return of your investment. Chartering a bank should be a reasoned decision, not a whim on behalf of the incorporators and shareholder investors.

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.

3.1.1.3 Working Together

Although the management team must guide the directors through the banking industry, because the directors will likely have only a basic knowledge of it, the management team reports to the directors. In this way a checks and balances system is integrated, ensuring that both parties work together for the benefit of the bank and its shareholders. Since the directors are not bankers themselves, it is critical to locate directors capable of understanding the banking industry, who are dedicated to performing the duties that will be required of them.

Directors must be prepared to oversee the day-to-day operations of the bank, because they are the ones who will ultimately decide whether or not the bank is performing up to expectations, and will take action in the event that it is not. The specific functions that the directors will have to supervise to ensure the bank's success are too numerous to mention, however, it is important that they monitor the following at a minimum:

- Loans, including internal loan review procedures
- Investments
- Asset-liability / funds management
- Profit planning and budgeting
- Capital planning
- Internal controls
- Compliance activities
- Audit program
- Conflicts of interest
- Code of ethics

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 2 -3 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 OCC, 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 an OCC (Office of the Comptroller of the Currency) charter you are governed by the 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 OCC charter. For example, lending limits vary by state, and some states, such as California, 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 an OCC 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. Samples of what you will likely need to include in the application are:

- The names and addresses of all of the organizers and the holding company (if there is one)
- The names of the proposed directors and management
- The name and address of the bank
- The number of shares, par value, and share prices for each share that will be sold
- The total amount of common stock, as well as surplus and reserves for operating expenses
- The number of shares of bank stock that each organizer plans to purchase
- Where the money for purchasing those shares is coming from
- Names and addresses of proposed investors who will own more than 10 percent of the bank's total stock
- A completed charter application for each organizer, proposed director and principal stockholder, CEO, senior loan officer, cashier, and all other executive officers
- Pro forma financial statements
- An addendum to those financial statements that explains assumptions and strategies to achieve the projected market share for each type of product or service
- Assumptions used to calculate earnings
- Everyone involved in the purchase or lease of the proposed bank building
- Any business or personal affiliations between the bank property seller or lessor and any of the organizers, other bank officers, and shareholders who will own 10 percent or more of the bank stock
- Copies of location feasibility studies and local zoning laws
- Copies of results of any environmental tests conducted at the bank's location
- Projected organization costs (this includes filing and regulatory fees, professional and consulting fees, payroll and payroll taxes, rent, capital-raising costs, printing, postage, telephone and office supplies)
- Proposed salaries and benefits for bank officers
- Copies of any employment contracts that may be given to officers
- Copies of proposed bank policies
- And finally, your detailed business plan!

As you can see, there is *a lot* of information that has to be gathered and submitted with your charter application. Leaving out any of this information, or having some of it incomplete, will slow down the review process considerably. 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 the state's department of finance and banking. 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 OCC 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. Items they look for, and may ask about during an interview, include:

- The full name, residences over the last five years, birth-date, birthplace, social security number, citizenship and other forms of identification for each proposed director, organizer and management team member. Any other aliases should also be listed, as well as the candidate's contact information.

- The applicant's full employment history must also be disclosed, including a list of former employers, previous positions, and the duties/responsibilities required by that position and how that experience relates to their proposed position at the bank. Identifying how work experience relates to a proposed position at the bank should be done regardless of whether the candidate will be a director or a member of the Executive Management team.

- In the event that the applicant owns their own business, such information, including their business and banking relationships, should be listed. Additionally, if the proposed Director has been affiliated with any other financial institution, in any capacity, that information needs to be supplied. Any omission in this regard, even because of a simple oversight, could result in the rejection of the application. This is because information not disclosed, especially regarding former associations with financial institutions, can be interpreted as deceitful.

- In addition to disclosing any relationships with other financial institutions, the applicant will also have to answer a number of legal questions regarding such relationships. Again, omission can be grounds for rejection, and could result in criminal action if the regulatory board feels the omission was an attempt to withhold information or mislead them.

- In regard to financial background, applicants should disclose their assets, liabilities, and net worth, including; cash, securities, real estate, notes payable and receivable, accounts payable, and mortgages to name a few, as well as the totals for both assets and liabilities and net worth. As with the biographical portion of the application, any failure to provide the fullest extent of information could result in rejection.

- Applicants should list a full description of any equity or debt on the open market such as, notes (including maturity and collateral), real estate loans, year-end financial statements, cash flow statements on investment property, business enterprises in which you hold a beneficial interest, assets, loans, and liabilities. If the applicant is in any way liable for the debts of others this should also be noted.

In addition to verifying the above information, Regulators will perform standard background checks of all proposed organizers, directors, and management staff through a review of records from some or all of the following;

- Drug Enforcement Administration (DEA)
- Federal Bureau of Investigations (FBI), which may include fingerprinting.
- Internal Revenue Service (IRS)
- United States Customs Service
- Securities and Exchange Commission
- Commodity Futures Trading Commission
- National Association of Securities Dealers
- Interpol
- Central Intelligence Agency (CIA)

- U.S. State Department
- Local law enforcement agencies

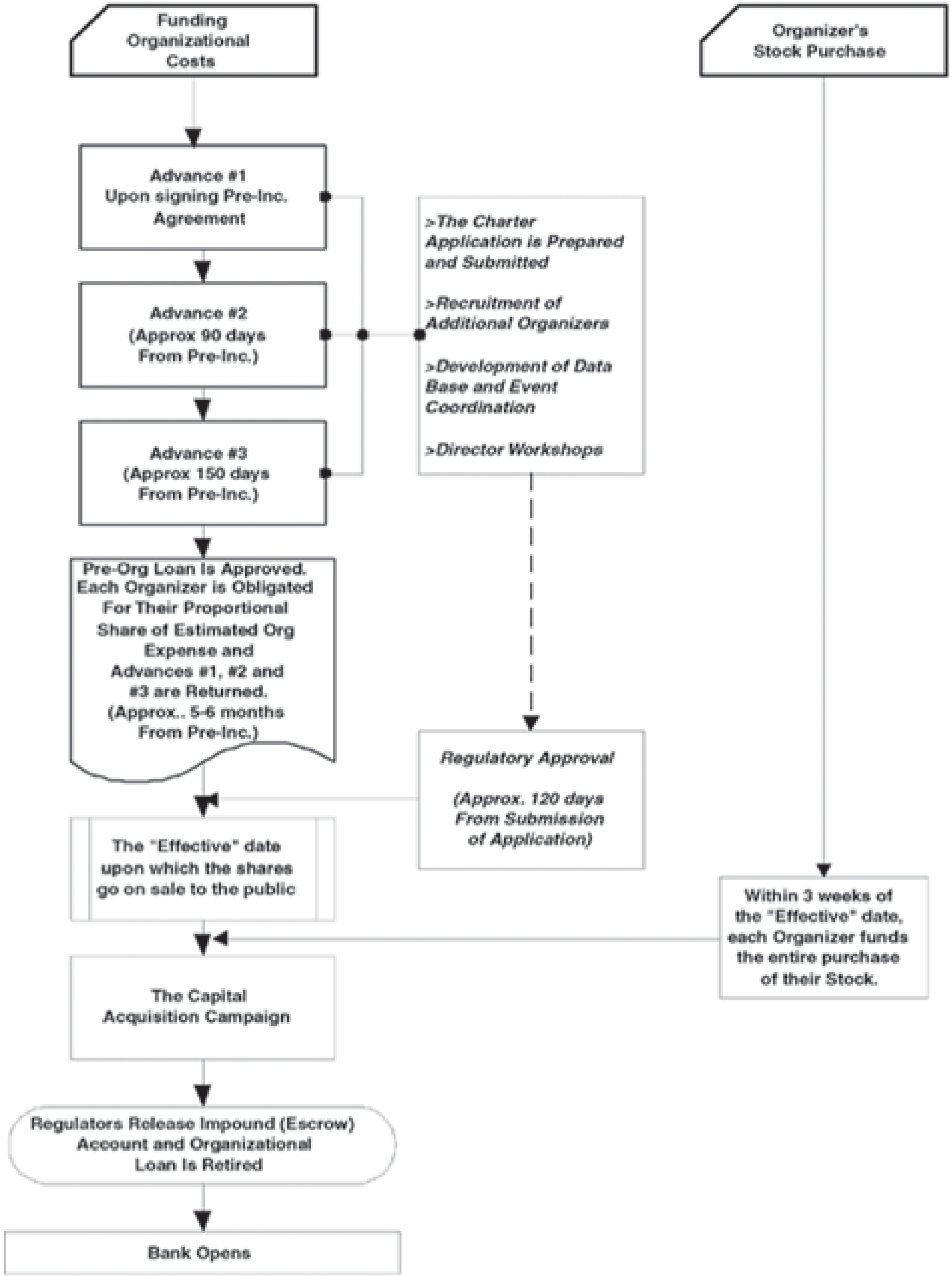
Regulators will also verify that all applications include a statement of authenticity or truthfulness from the applicant, as well as the applicant's signature.

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 comments, 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. The organization phase typically takes between 2 – 3 months to complete, depending on the rate at which you raise your capital.


Funding Organizational Costs
Organizer's Stock Purchase
Advance #1 Upon signing Pre-Inc. Agreement
Advance #2 (Approx 90 days From Pre-Inc.)
Advance #3 (Approx 150 days From Pre-Inc.)
>The Charter Application is Prepared and Submitted
>Recruitment of Additional Organizers
>Development of Data Base and Event Coordination
>Director Workshops
Pre-Org Loan Is Approved. Each Organizer is Obligated For Their Proportional Share of Estimated Org Expense and Advances #1, #2 and #3 are Returned. (Approx.. 5-6 months From Pre-Inc.)
Regulatory Approval
(Approx. 120 days From Submission of Application)
The "Effective" date upon which the shares go on sale to the public
Within 3 weeks of the "Effective" date, each Organizer funds the entire purchase of their Stock.
The Capital Acquisition Campaign
Regulators Release Impound (Escrow) Account and Organizational Loan Is Retired
Bank Opens

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 eight million dollars in capital only to realize that since you spent $800,000 on pre-opening costs you only have $7.2 million to work with. If your goal is to have eight million to open then you have to net that amount, which means you actually need to raise $8.8 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 seven million, however, eight million is a sufficient number in most cases, though 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?

Prior to receiving regulatory approval, the organizing group must finalize their business plan. Often times this process will require policies and procedures to be put in writing, in the form of a contract, to protect the bank, its employees, and its shareholders. Items to finalize, and account for financially, include:

- Operations
    - Loan Policies

    - Interest Rates
    - Standard Forms
    - Earnings Projections
- Marketing/advertising Needs
    - Mailings
    - Print Advertisements
    - Direct Marketing
    - Ongoing Demographic Research Plans
- Equipment and Supplies
    - Document Solutions
        - Copiers
        - Printers
        - Faxes
    - Workstations, including desks and chairs
    - Desktop items
        - Pens/pencils
        - Paper and paper accessories
- Salaries/benefits
    - Employees
    - Management
    - Directors
- Specification of Duties
    - Tellers
    - Management
    - Loan Officers
    - Directors

Finalizing these items will help make a smooth transition from the inception of your bank to its completion, and will help you determine an accurate budget for your operating needs, so that you are ready to serve your customers on opening day.

3.1.4.2.2 Who Can Help?

Although some form of banking, be it an actual bank branch or an ATM, can be found on almost every corner in America, the number of individuals who have actually opened a bank before are few and far between. Regardless of the individuals you have selected for your management team and board of directors, it is rare that any of them will have ever been part of a de novo bank before. In fact, most bankers have never actually opened a bank, which begs the question; who has?

Like any industry banking has its share of experts, some of which focus solely on opening de novo institutions. These individuals or organizations, at the most basic level, can help guide you legally and financially. Additional experts can be sought out for advice on publicity and technology.

Consultants: Consultants can help with everything from selecting management and organizers to completing the application and raising the capital. Many consulting firms specialize in parts of the big picture, while a handful offer a full spectrum of services.

Most de novo consultants include the application as part of their service, which means they should not only be able to help you anticipate what the regulators will want to see on your application, they should be able to use specific information on that application as well. For example, when discussing your business plan you will want to show accurate figures, such as projected income and expense statements, and the estimated date at which the bank will turn a profit. Producing such figures will require demographic research, which the consultant should be capable of performing or interpreting.

Additionally, a consultant should be capable of identifying red flags in a director's background that may prevent them from being accepted by the regulators, such as former financial or legal trouble. It is expensive and time consuming to start over in the event that a directorial candidate has what the regulators consider a flaw in their background, and consultants should be able to anticipate whether any such "flaws" will adversely affect your application.

A full-service consulting firm will also assist with vendor selection, name and logo development, capital acquisition, marketing, and director training, to ensure that your new bank is ready to enter the market.

Economist: A competent economist can prepare the application in a manner such that re-submission is for minor changes, or unnecessary. The economist should arrange a pre-filing meting with the Regulators to determine what that Regulatory authority is looking for in an application, and ensure such items are included.

As part of preparing the application, an economist can; assist organizers in preparing personal, biographical and financial forms; prepare market/economic analysis; prepare competitor analysis; prepare the business plan; assess market opportunities; assess management/board experience and contacts; prepare pro-forma financial projections; present management qualifications; communicate board committees/duties; prepare a CRA statement; and obtain state historical determination of the potential bank site.

As the economist gathers information and prepares the group for the task ahead s/he will maintain communication with the Regulators and Directors alike to keep all parties informed up to and following the submission of the application.

Lawyers: It is important to utilize the services of a lawyer when opening a bank, and that doesn't mean the one that is sitting on your board of directors. There are a lot of legal issues to be considered when opening a bank, and the legalese found on all regulatory documents is best interpreted by a competent lawyer, who has no tie to the bank other than to serve as an interpreter and guide.

Regulators have their own subtle language, which often includes many *unwritten* rules and policies. Lawyers understand this language, and can use this knowledge to help you communicate with the Regulators prior to and following the opening of your bank.

Market-makers: The primary function of a market-maker is to help the bank stay aware of its market status, as well as maintain an accurate interpretation of how they are viewed by the investment community. This is largely done through the facilitation of information between the bank and the community.

By monitoring a bank's performance in a marketplace and accurately relaying that information to both the bank and the investment community, a market-maker can help you accurately interpret the open market value of your stock, and inform your investors of your progress to ensure that your stock is trading at realistic levels.

Additionally, in the ever-changing world of banking a market-maker can assist with mergers, acquisitions, and capital augmentations by identifying a fair valuation opinion. Fair valuation opinions help provide a medium of exchange, which in turn will ensure that offers are relative to the bank's performance.

A market-maker is an important resource to utilize when opening a bank because of their un-biased interpretation of a bank's performance, which is the first factor to be considered when making decisions about fiduciary goals, the needs of key personnel, services, exit strategies, and ways to raise additional capital.

There are a lot of people out there capable of monitoring how a bank's stock is trading, but not all of them can interpret what that means for the bank itself, as well as its shareholders. Therefore it is important to consider these factors when looking for a market-maker:

- Does your candidate have previous experience as a market-maker
- Does your candidate have previous experience in the stock market such as;
    - Securities analyst
    - Advisor
    - Buy side strategist

- Has your candidate ever participated in a merger, acquisition or capital augmentation
- Has your candidate ever determined a fair valuation opinion and, if so, was it accurate
- Are your candidate's services tailored to meet the needs of your institution
- Has your candidate ever raised capital for an institution through;
    - Private client groups
    - Investors of bank stock

A qualified market-maker will have performed the majority of these tasks before, and will have the references to prove it. Market-makers can be found through a variety of banking resources, including your lawyer or consulting firm if they have extensive experience and contacts within the industry.

Internet Banking System Providers: These organizations are crucial if you plan to implement Internet Banking into your business plan. Although a sound competitive strategy in today's market, Internet banking is not a necessity, and does not need to be implemented before the bank opens in the event that your institution does want to provide this service.

To begin you must first identify what Internet banking services you wish to provide. Once these services have been agreed upon, you can then begin to look for vendors to provide these services, either by putting out a Request for Proposal (RFP), or evaluating a pre-determined array of providers.

There are two forms of Internet Banking System (IBS) providers; in-house and outsourced. In-house providers are just that, service providers who operate within your institution, in conjunction with your core processing system and data management software. Outsourced providers perform the same services, but not at the bank's physical location. There is no evidence to suggest that one type of provider is better than the other, however, many financial institutions utilize outsourced IBSs to monitor their costs, and improve and expand on the services they offer. Regardless of which type of IBS provider you choose, you should perform a risk management assessment and due diligence check on any potential vendor to ensure that individual/firm is capable of providing the services you want/need.

3.1.5 Final Phase: Post Conditional Approval (In Organization)

Once the operations have been finalized and the capital has been raised, the Regulators will grant their permission for the bank to organize, and you can begin to sell the bank's stock. Once the stock sale is complete and all procedures have been finalized and approved, you will receive permission to open your bank.

4 How Can You Participate?

There are a number of ways to participate in the formation of a new bank. For those who are qualified, sitting as a Director or Organizer will give you greater input, and greater responsibility. For those looking for a sound investment, purchasing stock may be an appealing option. Still others may want to just bank at the new institution, and promote success by telling the bank's story to others. Whichever you choose, you will be contributing to an organization that can improve your community's economic future.

4.1 Directors/Organizers

As a Director/Organizer you will play a big role in the eventual success or failure of the bank. Your responsibilities will be to attend regular board meetings, monitor senior management, recognize and communicate the needs of the community you serve, participate in continuing education functions such as seminars, and develop new business for the bank. In return for these services you will be eligible to participate in option programs, and the networking opportunities that will become available to you may develop into fruitful business and professional ventures. It is important to remember, however, that holding the position of Director/Organizer requires commitment, so we ask you to consider the following before you decide if this role is right for you.

Over the years we have worked with many organizing groups, and we are constantly amazed at how much in common they all have. The basic group profile never seems to vary measurably from city to city or state to state. We often share with each new group we meet the "rumor" within the industry regarding organizing directors. The rumor suggests that every organizing group consists of the same 15 or so individuals who merely change their names and slip on disguises as they move from one board meeting to the next.

Admittedly that is an over simplified and somewhat outrageous canard. However, the spirit behind the parody rests in the fact that there are really only three distinct and prevalent factors driving the members of every group. The factors are PRIDE, PERFORMANCE and PRICE. Yet interestingly enough, individuals interpret these factors differently.

For some:

PRIDE means doing the best job possible and accepting responsibility for their decisions and actions.

PERFORMANCE means the measure by which the organizers are willing to be held accountable during the bank's formation period as well as after it opens for business.

PRICE is the total cost necessary to engage the best resources, exercise the best judgment, and expend the necessary energy to affect the best outcome. In a word, professionalism drives many people to willingly invest the energy and resources necessary to produce first class results regardless of the character or scope of the task.

For others, however:

PRIDE is only a reflection of their egos. An opportunity to build a stage for self-perpetuation, which, in turn, clouds their view of the original mission.

PERFORMANCE is that action which they can direct and thereby control to match their own style, even though "their way" may be based on little or no understanding of the process necessary to successfully organize and lead a community bank. This is not to say that strong willed individuals who are successful in their own right are incapable of forming a bank, because they certainly can be. Rather the key issue is to be able to draw on the personal and professional strengths that strong personalities bring to the table and effectively integrate those traits into a team environment.

PRICE is that which the organizing group ends up paying to support the policies set by a group with limited vision.

Price of course is the operative word here. If the project is not orchestrated carefully, then the Price to the group and the community is extremely high as expressed by:

- Time and lost opportunity
- Mounting organizational costs
- Loss of faith by the community in the organizers

Launching a well-structured community bank can be rewarding for the organizers, the other shareholders, and the community at large. Yet the exercise is costly and entails a measure of risk. So each group should be confident that the Pride involved, the Price paid, and the level of Performance delivered reflects only the positive connotations of these elements.

4.2 *Investors*

As an investor in a community bank you will be supplying the funds that help that bank function, providing the quality services your community needs, while at the same time securing your own financial well-being. You can reasonably expect your investment to increase in value. Simply put, well-managed community banks historically return between 10-15% on equity (invested capital) with many banks exceeding that figure. The formula is fairly straightforward. Community banks with adequate capital, a strong board of directors, qualified management and a viable market become successful. Moreover, as the bank grows and generates earnings the value of the shares increase, which in turn creates a strong after-market for the stock. Further, should the community bank thrive to the point where it is an attractive purchase for a larger institution, you can reasonably expect to earn upwards of 2.5 to 3 times the shareholders equity.

4.2.1 Successful Community Bank Investing

Recent stock market activity and current industry trends, coupled with the professional experience of James R. Miller, Registered Investment Advisor, are the catalysts for this piece. In Miller's opinion, opportunities are at hand for the bank investor. The following discussion outlines some of the attitudes and practices he has observed in successful bank investing.

Before getting into the main thrust of this discussion let's first define the key elements involved. A COMMUNITY BANK is an institution serving a defined geographic and demographic locale and maintains an asset base typically less than $10 Billion. An INVESTOR is a person who appreciates long-term goals, usually a minimum of a 3 to 5 year time horizon. The successful community bank investor may be defined as one who seeks to accrue a rate of return between 10% and 15% on an annualized basis. This return equates well with the fundamental return on equity produced by a successful community bank. However, it must be noted that as an investor in a community bank one is holding stock in a small to micro cap company. As such the potential for periodic extreme price volatility exists. This is part of the risk a community bank investor assumes. However, market volatility does not necessarily equate to the fluctuations in the basic business of the bank. The stock market by its very nature fluctuates, and to be a successful investor one must be able to cope with price swings.

The market appears now to be truly a market of stocks. Trends have been lacking and movement has been punctuated with short-term violent moves. You may recall, during the Dot.com/Internet market frenzy, feeling like you were driving a Plymouth in the slow lane as the rest of the world was whizzing by in Ferraris. However, the market does have a way of "regressing to the mean" i.e. normalization of rates of return does occur through market adjustments. Simply stated, the tortoise wins the race. Successful community bank investors have reasonable expectations. The savvy investor invests in the business of the bank, not the stock. He looks to the management of the bank to make the institution a success. He allows enough time for the business cycle to progress rather than focusing on the movement of the stock. Short-term market fluctuations in share price do not affect the basic business of the bank. The investment is made with expectations in line with what a bank can reasonably produce. The risk assumed is the shared business risk involved in the operations of a bank (loan quality, general business cycle status, interest rate fluctuations, etc.)

Knowledge is King. Successful bank investors typically have a firm grasp of the fundamentals of the company. They acquire this information themselves or, more typically, with the aid of a professional; an advisor such as Miller who can give insight into the financial and market data. Also of importance is the ability to size up management with good old common sense—after all it's the people who make the numbers.

The successful investor is well ensconced in his "comfort zone." The portion of his portfolio devoted to investing in community banks fits well within the overall investment plan. According to Miller, the successful bank investor carries with him the principles of fundamental investing, i.e. adherence to the basic credo of asking whether the potential rewards warrant the assumption of the perceived risk. Here is where the assistance of a qualified professional will prove helpful. The expertise should not be limited to number crunching, but should also encompass the industry savvy to detect situations where a bank may be a probable candidate for a takeover by a larger institution. It should be emphasized that the possibility of a takeover/merger should never be the primary reason for investing in a bank, but it is an element to examine, as any such exit could be a boost to investment returns.

In Miller's experience, the most salient element in the formula for successful investing is PATIENCE. Patience to stick to an investment plan where fundamental progress is permitted to manifest; patience to stay the course through stock market gyrations and cycles of extreme; patience to SUCCEED.

While Miller acknowledges that all investments entail risk with absolutely no guarantees, he believes the current market conditions and fundamental state of the community banking industry present opportunities for investors. He therefore invites all interested parties to inquire about participating in a professionally managed account focusing on the community bank industry. As a Registered Investment Advisor, Miller is also qualified to handle accounts on a fee basis, thereby making the growth and safety of client accounts the only objective.

4.3 Customer

As with any business venture, profitability equates with success. Should a new bank not generate a profit, it will not be successful. You can, however, help ensure your new bank's success by becoming a customer, and encouraging others to bank there to increase the bank's customer base. The more depositors a bank has the more money it has for loans, which can support economic growth within the community.

By becoming a customer and encouraging others to do so, you will not only be strengthening the community, you will be generating business the bank needs to become and remain profitable, and to serve the community as it was intended.

5 Appendix A

5.1 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?

Table 1 NEW BANK CHARTERS			
YEAR	**NATIONAL**	**STATE**	**TOTAL**
1991	18	53	71
1992	9	21	30
1992	12	34	46
1994	19	30	49
1995	27	74	101
1996	51	95	146
1997	65	134	187
1998	52	138	190
1999	54	177	231
2000	___	___	192

The past decade has seen the largest number of new bank charters in the history of banking. Why have so many new financial institutions been started? The answer lies in the number of bank mergers that took place during the 1990s. There have been almost 4,000 commercial bank mergers within the decade. The total number of banks declined from 14,435 in 1980 to 8,315 as of Dec. 31, 2000. Many communities now have room for new community banks, and the growth of certain communities nationwide has precipitated the need for new commercial banks to meet the needs of the communities they serve.

This situation may or may not be true in your state. For example if the FDIC feels that in your state there is no room for a new bank, you may be pushing a rock uphill trying to get approval. On the other hand, if the regulatory agencies believe that new bank and thrift charters are reasonable under the proper circumstances, then filing for a new charter may be appropriate.

6 Appendix B

6.1 Timeline for the Five Phases

de novo Organizational Phases	Duration	Month1	Month2	Month3	Month4	Month5	Month6	Month7	Month8
#1 Pre-Filing Phase	15-30 days								
#2 Application Phase	60-90 days								
#3 Regulatory Review Phase	30-60 days								
#4 Capital Pre-Launch Phase	60-90 days								
#5 Post-Approval Phase (In-Organization)	90 days plus								

#1 Pre-Filing Phase
> Prepare Pre-Filing material for Pre-Filing meeting with regulators
> Facilitate Pre-Filing meeting with regulators

#2 Application Phase
> Prepare draft of State or Nat'l application
> Review, edit and file the appropriate application
> Prepare draft of FDIC application **(2)**
> Review, edit and file the FDIC application **(3)**

#3 Regulatory Review and Preliminary Approval Phase
> Prepare and submit offering circular for regulatory approval
> Regulatory field market analysis/organizer interviews by responsible agencies
> Regulatory analysis, comments and recommendations by responsible agencies
> Regulatory conditional approval by responsible agency **(4)**

#4 Capital Pre-Launch Phase
> Collect data, analyze market, build data base
> Develop Capital Strategy
> Form initial founder group
> Prepare and submit capital acquisition budget

#5 Post Conditional Approval Phase (In Organization)
> Conduct Capital Acquisition campaign
> Finalize premises, equipment, policies, procedure and staffing
> Obtain final approval from responsible agency(s)

Notes:

(1) Assumption is that the "core" organizing group is in place and pre-incorporation agreement is signed

(2) Some sections of the FDIC application can be prepared concurrently with State or OCC documents

(3) A site for the facility must be identified and details completed before the FDIC will accept the application for review

(4)"Responsible agency" can be the State Banking Department, or the Office of the Comptroller of Currency and the FDIC