

## De Novo Cyber Roundtable

**CB:** What would you consider the greatest challenge facing de novo banks?

**Flemming:** As president/CEO of a one-year old de novo bank, I believe the greatest challenge facing de novo banks today is the impact of terrorism on U.S. financial markets. New and stringent regulations, essential to combat the war on terrorism, increase the importance of Bank Secrecy Act compliance in de novo banks. The importance of a comprehensive ERM (enterprise risk management) policy and the coinciding responsibilities of CDD (customer due diligence) and EDD (enhanced customer due diligence) are critical to bankers to help us manage and mitigate the risk of money laundering within the United States and abroad.

**Scully:** In this particular market, de novo banks have even more than the normal advantages of being intimate yet generally well capitalized, partnered with state-of-the-art technology vendors, staffed by very experienced and dedicated teams of bankers and incredibly aware of and tied into their communities. However, they are being lumped in by the media, the legislators and even some regulators with the very large monolithic all-things-to-all people organizations that many of them just left. Small banks are only more likely to fail today than large banks because the large banks are rescued. Those rescues are being initiated not inappropriately, but of necessity because the full impact of decades of vast differences in who was regulated and how are now being seen.

Community banks and the subset of de novo banks are not against regulations; if their government affairs positions are examined, there is usually a remarkable consistency in the concern over discriminatory regulation that prejudices, ironically,

traditional financial intermediaries who know their markets and provides unfair advantage to those who have the business model and the resources to discourage portfolio lending and only reward selling rather than managing risk. The outgrowth of this belated effort to catch up on laws for brokers, investment bankers and funds managers may just provide the last straw to an already heavy burden of overhead that de novos struggle to fund efficiently.

**Hartheimer:** You need an effective strategic plan, and then you need to deliver on it — that is the challenge in a nutshell. This means picking the right team of executives, really knowing your market and your niche, and having the appropriate capital levels to support your plans. Today, you also need to be a realist about market conditions.

**CB:** What do you need to do to set up an effective risk management program for a de novo bank?

**Flemming:** As a de novo bank, I believe that to do it right and efficiently, you need to contract with a third-party risk management firm such as BKD, LLP out of St. Louis so that your team can continue with the real work of running the bank. The level of efficient technical expertise from a third-party firm allows confidence in the mitigation of risk.

**Scully:** Risk management is easier in a de novo than in a larger bank despite the relative lack of staff. First, credit risk is better managed because multiple layers of staff know the borrower and underwrite with the long-term view that this is a relationship, not a transaction. Interest rate and liquidity risk are the sum and substance of discussions of CEOs, CFOs and CLOs — daily, not quarterly. The fact that most de novos have very experienced bankers at the top who love banking and that those

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bankers talk to each other every day means that the three linchpins of any risk management system are in place: culture, experience and communication.

**Hartheimer:** Identify, measure, monitor, and report. Risk management starts for all banks, even de novo banks, by identifying the risks of your business ahead of time and assigning certain staff the responsibility of periodically measuring and monitoring those risks. Risks need to be reviewed and discussed among senior management frequently and reported to your board on a regular basis. While a de novo has a small staff and wouldn't require a full-time risk executive, assigning these responsibilities to a senior executive is both important and good training for the future development of a risk management program once your de novo graduates into the world of community or regional banking. **15**