FDIC Community Banking Conference: ***Strategies for Long-Term Success***

Transcript

Panel 4: Ownership Structure and Succession Planning

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MS. ELLIS: Welcome, everyone, to the fourth and final panel for our conference. My name is Diane Ellis. I am Director of the FDIC's Division of Insurance and Research. I've been looking forward for a long time to this panel. The topic this afternoon is ownership structure and succession planning. We're going to talk about some of the organizational management issues that are critically important to the success of community banks but that are really difficult to quantify and measure.

According to our FDIC research definition of community banks, there are some 5,735 institutions that meet that definition. That's about 93 percent of all FDIC-insured banks, the highest percentage in the last 30 years. Together they operate 33,409 banking offices and employ almost 438,000 people. These numbers clearly speak to the importance of the community bank sector. But what's more difficult to quantify is how these institutions are organized; what their ownership structure is; how management and ownership overlap; and then, finally, how community banks attract, retain, and develop new talent, particularly

managers and owners who are capable of assuming the reins when today's owners and managers are ready to pass them along.
We've got four panelists with us today, and I'm going to briefly introduce the four panelists and then turn it over to them for some opening remarks.

First, Rich Brown serves as the FDIC's Chief Economist and has been involved with our community bank research project from its inception. He's really been our leader in this area since our original 2012 Community Bank Study. Since then, we've had ten additional studies published by a number of authors from the FDIC, again, with Rich taking a leadership role. He's going to be talking today about one of those more recent studies on the financial performance and management structure of small, closely held banks. He'll be showing some of the work that he and other FDIC economists have done to quantify some of these issues, like how institutions are organized and what their structure is, which to my knowledge is the first of its kind.

Then we're going to move on to Brian Riley, who is President and CEO, and a Director at Mohave State Bank, a $325-million institution headquartered in Lake Havasu City that describes itself as one of the oldest and largest community banks in Arizona. Brian has had a distinguished career in the financial services industry and currently serves on the board of the Arizona Bankers Association and the Federal Home Loan Bank of San Francisco.

Then we're going to move to our second banker on the panel, Tim Schneider. He's the CEO of Investors Community Bank, an $884-million institution headquartered in Manitowoc, Wisconsin.

Tim has been in the financial services industry for over 25 years, specializing in agriculture and commercial banking, and was a co-founder of Investor Community Bank in 1997, and he's managed its growth into a public company with two full-service and four loan-production offices in Wisconsin.

And then, finally, we're pleased to have on our panel Sorin Sorescu, who serves as the Chair of the Department of Finance at the Mays Business School at Texas A&M University.

Professor Sorescu's research is focused on short sales and the informational content of security prices, asset management, market efficiency and macro finance, but more importantly and relevant to this topic is that he is co-founder of the Commercial Banking Program at the Mays Business School, a flagship intern program designed to equip students for a career in commercial banking, a very unique program providing some of the educational needs of community banks.

We're going to start with Rich.

DR. BROWN: Thanks, Diane. Good afternoon, everyone.

This is research that we put together last year. We had a sense that family-owned or otherwise closely held institutions were very important, and we didn't know enough about them. We conducted some research in 2015 to explore the topic. We presented it first at the St. Louis Federal Reserve/Conference of State Bank Supervisors Conference last October. We published it in the *FDIC Quarterly* earlier this year.[1]

Some of you have already seen this presentation, so I hope you won't mind sitting through it again. Those of you who haven't seen it, I hope you don't mind sitting through it for the first time.

We had a sense that these closely held institutions were a unique class of institutions. It's not your classic corporate form. Many times they're based on family or community ties, and we had a sense that they could also face special challenges. Maybe access to capital would be a challenge. We've heard about the liquidity of the capital as well as a challenge, perhaps, acquiring talent and capabilities serving larger customers and markets.

We were interested to know if these were special challenges for these institutions. What we found was that small, closely held institutions were really mainstream among community banks and that this organizational form did not turn out to be a problem. It was one of the keys to their success, which I'll explain.

We wanted to know about ownership structure first, concentration of ownership. We asked the question in terms of whether there was an ownership group, an individual or a group based on family or community ties that exerted a deciding influence over the governance of the institution. When we thought about it from a theoretical perspective, whether and how it would affect operational efficiency, there were really reasons to think that it could have benefits or liabilities when it came to efficiency.

In terms of the benefits of closely held ownership, closely held banks may be less beholden to quarter-to-quarter pressure from the financial markets to meet return targets. They may have a better opportunity to pursue longer-term strategic goals. That could be a good thing. Also, closely held banks could be more likely to monitor management because the returns to that monitoring accrued to those owners and not necessarily to external shareholders who were along for the ride. Those were reasons why closely held ownership might be good.

In terms of the cons, did closely held institutions have more trouble raising capital? There's also the possibility that they could pursue goals other than strict profit maximization. Again, some of these other uses of the institution's resources may be perfectly compatible with being a community bank. It's supporting the community, community activities, but they may have an effect on the bottom line.

We also wanted to know something about the overlap between ownership and management and the degree of overlap and why that overlap could be good or bad. In a pure principal/agent sense, when the interests of owners and managers don't coincide, that's an agency problem

[1] Anderlik, John A., Richard A. Brown, and Kathryn L. Fritzdixon, "Financial Performance and Management Structure of Small, Closely Held Banks," *FDIC Quarterly*, Volume 9, Number 4, 2015, https://www.fdic.gov/bank/analytical/quarterly/2015_vol9_4/article1.pdf.

that can tend to lower efficiency. The overlap could be a benefit to the performance of the institution.

But on the con side, if management and ownership are the same group, it could vastly reduce the pool from which the organization could get managerial talent going forward. It couldn't just put out an ad and bring in new management if it had to come from that ownership group.

In addition, that succession could involve transferring both ownership and management at the same time. Again, that liquidity of the capital stock is something at issue to deal with there.

As Diane mentioned, this is not an area where there's a lot of data that are available. So we went to our examiners in the regions. We went to the [FDIC] Kansas City Region, talked with [Regional Director] Jim LaPierre and his group, and came up with a survey of 11 yes or no questions that we wanted to ask examiners about community banks that they had examined during 2014 and the first quarter of 2015 that deal with the concentration of ownership, overlap between ownership and management, and succession issues.

We eventually expanded it to three regions—the Chicago, Dallas, and Kansas City Regions—I think about a 21-state area between the Rio Grande and the Canadian border and between the Appalachians and the Rockies where we surveyed almost 1,500 institutions in total, and about 1,300 of those were community banks.

What we found basically was three-quarters of those community banks surveyed actually met our definition of closely held, with an identifiable primary owner or ownership group. Of these, 83 percent of those closely held were joined by family ties, 85 percent of them were joined by community ties, and 92 percent of them had both family and community ties that brought those ownership groups together.

In terms of overlap between ownership and management, that also turned out to be pretty prevalent in all. In 57 percent of those closely held institutions, the key officer who made day-to-day decisions was either a member of that ownership group or could otherwise be considered an insider. Overlap was fairly prevalent.

In terms of succession, that turned out to be an issue both for the closely held institutions and the widely held institutions. Fifty-two percent of closely held community banks have identified a viable successor. That's actually a little bit higher than for the widely held institutions. They have 46 percent. But just 62 percent of the closely held institutions were deemed to be well-positioned to recruit qualified management from the outside compared to 69 percent for the widely held.

Clearly, succession is an issue on the table for both closely held and widely held institutions. But, as I mentioned, when your business model depends on having ownership and management overlap, that could be an issue.

Now, let's look at performance. When we compared the performance of closely held and widely held institutions, we found that closely held clearly outperformed. This [pointing to the chart] shows return on assets on the left and return on equity on the right. But when we broke it down according to the management overlap, we found it was those closely held institutions where ownership and management overlapped that clearly outperformed either the widely held institutions or the closely held institutions where management was not part of the ownership group. We estimated a regression model to hold constant some of the other factors that may influence it, such as geographic location, business line, things of that sort, and what we found was that the overlap variable was the significant variable, and that it was worth about 12 basis points in return on assets, which is pretty substantial when you consider that pretax return on assets for community banks nationally last year was 1.27 percent. It's a pretty significant benefit there. Looking at efficiency ratio shows the same thing. The efficiency ratio is much lower, that is better, for the closely held institutions where there's overlap between ownership and management.

I would say a couple of other comments here as we wrap up. I mentioned that we had held constant those other factors and identified a significant variable for the overlap worth about 12 basis points.

I think the big takeaway there was that, again, the prevalence of this closely held organizational form was something that shouldn't have surprised us. Perhaps it did, and perhaps it relates something to the fact that in the Plains states, the middle of the country, these are pretty old charters. Forty-three percent of the charters for the closely held are 100 years old or more. That's pretty prevalent. I mentioned, of course, the outperformance of the closely held institutions where there's management overlap; this suggests that on balance those benefits of concentrated ownership and overlap tend to outweigh the potential costs.

We also looked at capital raising. The closely held institutions do tend to raise most of their capital—in the six-year period that we looked at—they raised 60 percent of their additions to equity capital through retained earnings. That's compared to 48 percent for the widely held institutions. But when we looked at external raising, the closely held institutions still raised almost as frequently from external sources in each given year as the widely held institutions.

The one downside here, the one thing that is concerning, is that this solution to the agency problem where you have management and ownership in the same group, it does require that you replicate this recipe for success when it comes time to pass the institution along.

You do have a smaller group to recruit from. You have to find owners and managers in the same group to have the same recipe for the next generation. While I think the research is positive—it's hopeful, it shows this business model works—I think it does point to one vulnerability, and that is how you make it work after you pass it along to the next generation.

That's maybe a little backdrop for our other panelists to follow up on as they consider these issues.

MS. ELLIS: Rich, I thought the results on performance are particularly interesting. Are there any demographic explanations for differences in performance, things like location, asset mix, so on?

DR. BROWN: Well, there are. As I mentioned, with the closely held institutions there is a connection to geography. They do tend to be more often located in rural areas. They're 1.7 times as likely to be headquartered in a rural area as the widely held institutions. They're 2.4 times as likely to be located in a depopulating rural area. In some cases these are places where the local market is not growing. But, during this sample period at least, they were more likely to be agricultural specialists. That was a significant variable in the regression. They were more likely to be a diversified nonspecialist. Again, it's an outperforming line of business. These were all significant variables in the regression showing some of the differences from widely held banks.

Even after accounting for those influences, still, the overlap between ownership and management was worth 12 basis points of ROA [return on assets]. There is something there still for the organizational form that explains higher level of performance.

MS. ELLIS: Okay. Thanks.

Alright. Rich has laid the groundwork for this panel. He's talked about an ownership structure that is very typical for community banks, that is, being closely held and even family owned. He's talked about some of the benefits of that, even better performance sometimes, but also some of the challenges, meaning capital raising and management succession—management and ownership succession.

Now we're going to move on to the bankers on our panel, who are going to address how they've met some of those challenges. Brian?

MR. RILEY: Thank you, Diane.

I'm Brian Riley. I'm President and CEO of Mohave State Bank. We're in Lake Havasu City, Arizona, a 25-year-old organization. Succession both in ownership and in management now is becoming a particularly relevant discussion at our board table. We have $330 million in assets. We have five branches. We are in Western Arizona. It's basically equal distance between Phoenix and Las Vegas, out in the middle of nowhere, which is important when it comes to staff development.

We have a holding company. We operate under the holding company. In fact, in February we just announced an acquisition of another bank in an adjacent market which will add another $200 million in assets and another four branches. We are a C Corporation. Our shares do trade on the OTC [over-the-counter] market. We are not a public filer and are trying to do everything we possibly can to ever avoid doing that.

I thought it would be interesting to share some of the current reflections that our board is having and some of the strategies that we're putting in place. I can't tell you that they're the most effective, but I can tell you what is working and some of the things that haven't worked quite so well.

When we finally arrived at the conclusion that our near-death experience was over, we started to focus on the issues of sustainability and succession. One of the things that we discovered is that our shareholder base, which is primarily our local customers, was pretty easy to run a demographic study on. We just overlaid our deposit customer demographics right on top of our shareholder base and discovered that our shareholder's average age was 69 years old.

It suddenly led us to the belief that in the next 10 to 15 years there may be some issues relative to liquidity as shareholders do estate planning and also some of the retirement needs. We also were a little worried that the second generation or the heirs of our founding shareholders may not necessarily have the same allegiance to the community as we do, as founders and owners of the business. That also made us think that we need to put some strategies in place.

What we did was really two-prong. One, we initiated an ongoing share repurchase program. We simply announced a total amount of cash capital we were willing to retire, and we just let that be out there in place as the basic level of liquidity in our shares.

The second part was that we activated a very strong and robust investor relations effort, focused on not only retail customers but also on institutional customers, or institutional shareholders. We have a very interesting and compelling investment story. We thought it would be good to start attending some of the conferences and sharing that story with them.

What we found is that because there are very few banks in Arizona, that story resonated quite well, the result of which is two or three years ago we were trading 50,000 shares a year. Last year we traded 500,000 shares. At the same time, our stock went up 40 percent. I think we have definitely dialed into something that's working.

In terms of board succession, our original board members, in drafting the bylaws, put in a hard and fast retirement date. That age is 70 years old. During my tenure and over the last eight years, our board has fluctuated from eleven to seven as we add new members to prepare for retirements, and we let it go back down. During my time, we have retired five founding directors. We've recruited three new directors, and I've had to ask two of them to resign. There's a little experience here in terms of board succession.

For our retiring directors, we tried a program which was the Director Emeritus Program. We allowed them to stay active with us, not voting but attend board meetings, be involved in governance until they were 75. When the last one hit 75, we canceled that program. It was becoming a little unruly to have 20-plus people in the board room.

In terms of recruiting new directors, we certainly look for complimentary skill sets. Right now we're more focused on retail experience, marketing, and accounting. We also look for personality fit, and I think business judgment naturally is part of that mix.

When the bank was founded, we had community boards in all four of our markets, and over time some of those community board members were drafted, if you will, onto our board. However, it was becoming quite a task to operate four community boards, particularly when the needs of the business were accelerating. So in 2013, we held our last community board meetings and thanked them all, and we moved on.

Our practice has been when we appoint new directors, we appoint them first to the bank board, and we give them a year or two of experience to make sure that they are comfortable with what their liability is, make sure we're comfortable with them. And then after that one or two-year time period—called the proving period—we actually put them on the slate of director candidates for our holding company shareholders.

In terms of management succession, I was really fascinated with the discussion of millennials, because that has been a real issue for us. Our average age of employee base is 47. Fifty percent of our employees are over 50, and 25 percent of our employees are over 60. Our youngest employee is 18. Our oldest employee is 77. What we're concerned with at this point in time is that vast rich knowledge transfer occurs from more senior, tenured employees to our younger employees. We're working on some efforts to do that, which I'll discuss in just a second.

In terms of our executive management team, I think we look a little bit like a laddered bond portfolio. I'm in my 50s. Our chief credit officer is in his 60s, and our chief financial officer is in his 40s. The most logical choice for a successor is our chief financial officer, and I'm working with him right now. I think the board is focused on him. As to whether he wants to assume the role over time, we're certainly hoping that he will venture to do that. We're working on some development plans for him specifically.

The most exciting opportunity and where the millennials come into play is we have an unbelievably outstanding second tier of leaders. Many of these individuals actually grew up in our bank because we're out in the middle of nowhere. Folks will come to work for us at 18 and then move from being a teller to go in the back and be a credit analyst. We've really had to have very specific and detailed training and development programs.

For the development of these individuals, I'm going to call them our emerging leaders, there are 12 of them that we've identified, and we're working on very specific career paths. Some of them aspire to my role. Some of them aspire to our chief financial officer role. Some of them aspire to our chief credit officer role. We have some traditional things that we do. Tuition reimbursement, I think we've certainly put several folks through their college education. We've sent folks to banking school, and we also have some internal leadership training. That's where it becomes a little bit more unique. We made a decision that all of these individuals should sit in every one of our board meetings and all of our board committee meetings. Part of that is to get them comfortable making presentations to the board, answering interactive questions, learning the governance of the business. Secondly, we created a formal mentoring program, where we rotate each of these individuals with another executive officer every successive 90 days.

We've also decentralized our decision making. We've created a few operating committees, empowered those operating committees to make decisions. Of course, we have the right of veto, but we want to give them experience to understand the risks involved in making decisions and understand the rewards in making those decisions.

I think our biggest challenge, though, is the rural environment in which we operate. We were just talking earlier about large bank training programs and the fact that they don't exist anymore. Part of our issue is just attracting people to come out to our area, although it is the spring break capital of the United States. I just want you to know that.

There's an academic concept called secondments, and I'm trying to flirt with how to possibly implement this. A secondment is essentially where you assign a staff member to another company for a period of time, with the agreement that they will go gain some experience that you can't provide and come back. I'm not exactly sure how this may work, but one of the elements of secondments is I'm working with our trade association to create more peer-to-peer mentoring. There are just certain types of business transactions, certain types of financial statements, certain types of businesses that we will never see in our environment that would be incredibly helpful for this group to learn. We're attempting different things, and it seems to be working quite well.

MS. ELLIS: Alright. Thanks, Brian. You've touched on a lot of the challenges we mentioned. I want to just ask you one follow-up question going back to the capital raising.

I believe during the severe real estate recession that occurred in your area and other areas of the country, your bank had to recapitalize. Can you talk about what the options were that you considered and how that was accomplished?

MR. RILEY: It was not easy. I'll share that with you. At one point in time we had actually evaporated 40 percent of our capital base. It was clear that we were going to have to raise some capital. I went to the board and said it has to start right here, and it has to start with me. I was the first one to put my check in the hat, and I sent it around the board table, and I was really surprised at how much the board stepped up, and that made the sale in the community easier when I went out to ask for additional investment. We started first with a debenture, a convertible debenture with a very high coupon rate, but then on the second level of capital raise we actually just went out and sold common shares at 25 percent of book value.

MS. ELLIS: Okay. Tim?

MR. SCHNEIDER: Thank you, Diane.

As Diane mentioned, we're a $900 million institution approximately, headquartered in eastern Wisconsin right along Lake Michigan, about 30 minutes south of Green Bay. I and three other gentlemen founded the bank. We worked for a large national bank headquartered in Milwaukee at the time, First Wisconsin, Firstar, now U.S. Bank, before we broke to start the bank. We primarily focus on the agricultural and commercial sectors of business. We have a very niche-focused bank. We do very little retail. Our retail primarily consists of deposit gathering, primarily CDs, along with the other funding that we receive from our commercial and agricultural customers' deposit accounts that are at the bank.

We were capitalized back in 1997 with about a $6.5 million capital raise that we did locally. Fortunately, one of our founders of the bank, who was the former CEO's father, started the bank that became Firstar Manitowoc back in 1965, and I think because of his success and the shareholders' success through the years, that was a quite easy sale, and the bank sold out our shares in about 30 days. Our initial offering went quite well.

Additional capital offerings along the way, we utilized TruPS [Trust Preferred Securities], as many of you probably did, early in our existence for about $12 million worth of capital. We did do a secondary offering back in about 2009 to 2010, when we opened our second branch in Stevens Point, Wisconsin, which is in central Wisconsin, and, again, raised about $6.5 million, much of it coming from the local market. Surprisingly enough, we were able to sell that offering at 120 percent of book value at that point in time in the market, which was not very common.

Our model is very branch light, as you understand. We only have two branches. We have 112 total employees, about 100 FTEs [full-time employees]. As I mentioned, we're very niche-focused on the agriculture and the commercial sectors and continue to be so. We did take the company public back in January of 2015. We're now trading on the NASDAQ. We felt we had a very successful offering. About 80 percent of our offering of about $20 million was sold to institutional holders. We do still maintain a 32 percent insider ownership ratio at this point, our Section 16 officers and insiders and board members, still a significant ownership aligned with our shareholders.

Primary motivation for taking the company public back in 2015 was, first and foremost, liquidity. We had a number of shareholders that were aging, in their 70s looking for liquidity play, and we weren't sure long term we were going to be able to provide that liquidity without having a public stock.

Second motivation was having a currency. We had been talking about making acquisitions for a few years and thought having a public company currency to take to the table for an acquisition was going to be an important component. We're one of only six publicly traded currencies in the state of Wisconsin from a banking perspective. It brought us a different motivation for a potential seller.

What have we done on the M&A [mergers and acquisitions] front? Back in November of 2015, we announced our first acquisition. We're acquiring a bank that's headquartered in Appleton—

The Business Bank. They have a secondary location in Green Bay. Our primary motivations on acquisition were to find a diversification play. Currently about 65 percent of our book of business is agriculture. We do have about $500 million of agriculture loans that are actually off balance sheet. They're either Farm Service Agency government guaranteed loans that we've sold on the secondary market or participations. We've used that to manage our concentration levels, those two tools, but we definitely wanted to look for a business-bank-focused acquisition.

Some of the other benefits that the acquisition brings us, as we talk as the panel hot topic here, is the talent attraction. Manitowoc, being about a town of 35,000 people, has a very limited ability to attract talent as the bank continues to grow. To the east is Lake Michigan. So unless we're going to employ lake trout and salmon, we're probably going to be challenged in trying to find talent. These two markets are much larger, a lot more banking opportunities in those markets. We're excited about that facet of the acquisition as well.

From a succession planning standpoint, I was down to be the future CEO about 12 years ago by our board of directors in a strategic planning session. Lengthy discussion without me in the room. A little gut-wrenching to know that being one of the founders of the bank and still one of the significant shareholders whether I was going to be allowed to take on that role.

Our former CEO, my predecessor, Bill Censky, came up with the concept of a co-CEO role. Historically, I had been a commercial and agricultural banker. I grew up on a large dairy farm not far from the bank. I understand the primary industry that we serve quite well, but I needed to have some background in other areas of the bank. We shared the co-CEO role for two years, the first year of which Bill was calling most of the shots and I was learning. Second year of the transition, Bill let me take the reins, which is not easy as our largest shareholder in the bank or second largest shareholder for Bill to give up those kind of controls. He was very gracious in allowing me to put my own color around the bank and provide some different leadership and strategic direction for the organization long term. That's been an exciting process, and I think that co-CEO situation worked out quite well for us.

From a succession planning standpoint for the balance of our organization, we do have formal succession plans for all eight of the executive level roles that we have at the bank. We haven't clearly defined who my long-term successor is as CEO. There are a number of candidates in the bank that we're grooming to potentially take on that role at some point in time. I'm 50. I have a little bit of a run left in me hopefully, God willing. We're working on that succession plan for my role, but we do have documented plans for the balance of the executive team.

We did also implement a formal internship program in the organization a couple of years ago as we continued to be challenged in attracting talent, and that's been quite successful. We're starting out fairly modestly. I think we're going to have three interns this summer performing different capacities within the bank, primarily credit-focused, both in our commercial and agricultural side, but we want to provide them some opportunities to be exposed to different areas of the bank so they get a broader perspective on how the bank is operated.

We also have utilized the Graduate School of Banking (GSB) Program out of University of Wisconsin–Madison. I'm a graduate of that program, the first one of our institution to participate in that. We've had a couple of other attendees to those sessions, and we do have another individual that will be joining the GSB Program this year. This is a good way for them to again be exposed to a broader banking experience.

From a board succession standpoint, similar to Brian's organization, we did set in our bylaws early in our existence a mandatory 70-year retirement age, which has proven to be a good thing, I think, although one of the directors that retired a number of years ago probably could have continued to serve, and he's now pushing 80, but I think we made the prudent move in setting that limit.

From a succession standpoint, we do have a formal board matrix. We like to have a varied skill set on our board and try to manage to fill some of the gaps that we have needed through the succession and retirement process. We did add one new board member recently. Considering we took the company public, we felt we should broaden it out and have somebody with some public company experience. We were able to obtain a woman that is a board member on a couple of other large public companies nationally who joined our board back in November.

We're also looking to add a couple of new board members through our acquisition that was part of our agreement, and we have determined who those additional board members are going to be. We've continued to look for talent there. We're going to be up to 14 board members. That's probably about as large as we'd like to serve, four of which are the four original founders of the bank that still serve on the board, including me.

In addition, we do have an advisory board in our branch location in Stevens Point. I guess unlike Brian, we haven't used that as a feeder system for our current board. We primarily use that for feedback in the marketplace, and that's been a valuable tool for us.

We've had an interesting run. We're looking to take the bank to bigger and better places, and the goal is to be about $1.5 billion as an organization in the next three to five years, and the acquisition is going to put us at about $1.2 billion. It's been an exciting 19-year history of the bank. Thank you.

MS. ELLIS: Thanks, Tim.

I found it interesting in Brian's opening remarks it sounded like he has no interest in becoming a public institution. Tim, you guys made a different choice. Can you talk about how your regulatory compliance burden has changed since becoming a publicly traded institution?

MR. SCHNEIDER: It's definitely changed, and we went in eyes wide open. Obviously, the costs are increased, the additional audit and compliance costs involved, the SEC reporting that's required, but we felt the reward was, obviously, the full currency, our full liquidity, as well as the better pricing. Since we've taken the company public, we're trading at about 120 percent of book. Prior to that transaction, when we were private, typically our transactions were book or book minus. Obviously, we came through some tough times in the banking space that probably depressed that multiple, but as we understand it, as the bank moves into that $1.2 to $1.5 billion range, the multiples do increase. We feel there are definitely benefits that outweigh the costs and the additional work that's involved in being a public company.

MS. ELLIS: Thanks. Okay, Sorin?

DR. SORESCU: Thank you, Diane.

I would also like to thank Rich and the organizers for the invitation. I appreciate it very much.

At Texas A&M University, we provide a solution for the front end of the succession planning challenge. We do so through our Commercial Banking Program.[2] This is a program that is designed to educate primarily undergraduate students in commercial banking, particularly with an emphasis on the community banking sector.

Our program started about five years ago, in response to what we perceived at the time to be a gap, a talent gap in the community banking industry. Two community bankers from the State of Texas—Robert Messer from American National Bank of Texas in Terrell, Texas, and Dwight Garey from Amegy Bank in Houston—approached me around 2011 and asked if we had any idea at A&M on how we can service the community. We created that program in part because of those conversations.

Students are selected from the general undergraduate population based on a combination of academic credentials, their interest, which is incredibly important, their interest of working in community banking, as well as what we perceive to be their fit for that particular industry.

In the program, students are taught a combination of quant skills and soft skills. On the quant side we're offering specialized courses in commercial banking, credit risk analysis. We're in the process of offering for the first time a course in enterprise risk management, and those specific for the commercial banking program, of course, in addition to our other courses that are accessible to all students: valuation, financial modeling, financial statement analysis, private equity, fixed income, real estate. I need to mention that the courses in credit risk and enterprise risk management are sponsored by the Risk Management Association. They're a big supporter of our programs. They also make scholarship opportunities available for our students.

On the soft skills side, students are mentored throughout the program by our very active advisory board. The advisory board sponsors the program financially in terms of sweat equity. They come to campus twice a year. They meet students in all sorts of activities, and they establish more or less a one-on-one mentorship between a board member and a student.

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[2] For more details on the Texas A&M Commercial Banking Program, see http://mays.tamu.edu/department-of-finance/commercial-banking-program/.

When we started the program, we had nine banks, members of the advisory board. We are currently at 33 and growing, and then we have two *ex officio* members, the Federal Reserve Bank of Dallas and the Texas Department of Banking.

Members of the advisory board also come to campus once a year to guest lecture in the program. We have a course that is essentially a series of guest lectures, and they conduct case studies, the idea being that there are some skills that we, academics, cannot necessarily teach because that's not our area. For example, how do you evaluate the financial statement that hasn't been audited? How do you use your intuition to know whether this is going to work or not work in terms of making a lending decision? I think the program is really a success story of combining both what we bring to the table on the academic side as well as what the industry brings to the table.

Finally, every student in the program is offered an internship, a summer internship with a member of the advisory board. Those internships, as is the case everywhere else, give students an opportunity to eventually be considered for a full-time position with the bank.

At the moment we face two challenges. One is in terms of growth. The other one is in terms of diversity. Let me address growth first.

We have probably a larger supply of internships and jobs in the state of Texas than we have students currently that are interested in joining the program. It's a nice problem to have, and I'm going to tell you how we are going to address it—or we try to address it—after I speak about the diversity problem.

The diversity problem is, of course, all of us would like our graduating class to be a cross-section of the population of the state of Texas. That is not the case, unfortunately, at the moment, and we'd like to change that. To address both the growth and the diversity problem, I have approached the Texas A&M system, which is the entity in charge of all schools that are part of the Texas A&M network within the state of Texas. They're spread out all over the state. We have really nice geographic representation, and I've asked if they'd be interested in having all of these schools partner with us so that we can recruit from those schools and they can come and spend the final year in College Station and be part of the banking program. I think that this would help with numbers, and it would also help in terms of diversity, especially given the geographic representation of these other schools. We don't have a final answer yet, but that's our answer—our solution to the growth and diversity problem.

In the end, our goal is to become recognized as a premier educational program in commercial banking, not only in the state of Texas but in the United States.
Thank you.

MS. ELLIS: Sorin, it's interesting to us that so few academic institutions have a commercial banking program. Why do you think that is? Why is your program so unique?

DR. SORESCU: Can you rephrase the question to make sure I answer it correctly? Are you asking why it hasn't been done before by others?

MS. ELLIS: Yes, why don't colleges around the country train people to be commercial bankers?

DR. SORESCU: I don't know that I have the answer to the question. I'd be a bit hesitant. I'm going to try to give you an opinion.

Institutions of higher learning, as you know, need to focus on research as well as teaching. When I went to grad school at the University of Florida, I worked under Mark Flannery, from 1992 to 1996. Commercial banking was a hot area at the journals. Institutions of higher learning get ranked. People do not represent academia. I've been on the record saying that before, but, nonetheless, they rank us and they tell us here are the journals where you have to publish. And then there's been less of a taste at some of these journals to publish pure banking research lately. I think that what we did at A&M is we disentangled our mission to advance knowledge from our mission to educate the population, and we said there's no reason why we shouldn't be able to do both, but I think that some schools are perhaps not ready to do that.

MS. ELLIS: I know your program is relatively new, but can you describe a general profile of the students that choose to be in this program, and do you have any notable successes? What jobs do they take when they leave your program?

DR. SORESCU: I don't know the exact statistic. The overwhelming majority end up working in commercial banking, most of them for one of the member banks, most of them in credit, as lending officers. We have developed a community at Texas A&M where students are incredibly passionate. They belong to the community. They go out and they organize their own events. They print t-shirts. They advertise the program. They really own the program, and I don't think the program could be a success without the students owning it.

Eventually what makes the program successful is that the members of the advisory board have managed to educate at least one segment of our student population that this is an exciting career, which was not something that *ex ante* was necessarily going to be guaranteed as a success. As I'm sure you know and it's been brought up before, everybody comes in wanting to be a finance major thinking they're going to work for a hedge fund or an investment banking firm in New York. Our goal was to understand that we have a mission to the state of Texas and that starting this program is an important and effective way for us to fulfill that mission, and educating the students to be interested in the field was very important.

MS. ELLIS: Alright. I'd like to ask maybe our two bankers, Tim or Brian or both, to react and maybe tell us how do you view the role of on-the-job training versus formal education in developing community bankers and what sort of educational background are you looking for in your employees?

MR. RILEY: For officer-level positions we certainly look for traditional background—finance and accounting. In terms of on-the-job training, I don't think there is anything that is more important. I call it the old guy, or the grey hair, no hair syndrome, and that's what I was trying to imply when I talked about our second tier of leadership. It's getting them in front of those experiences that you may only have once in a lifetime. Certainly, the most recent downturn was an excellent opportunity to experience something that hopefully most of us will never experience more than once, but experience on the job is absolutely critical.

MR. SCHNEIDER: I would pretty much echo what Brian said, but I think another important piece to mention is the on-the-job training that can be beneficial as to how a particular organization may operate. We operate fairly uniquely, I think, relative to other banks in our space. I think integrating them in the culture is important as well. The economics/finance/management backgrounds are critical I think, but I do think we've had a few people that have come through the ranks, especially in our agriculture space on the lending side, that actually don't have college backgrounds and just understand that industry quite well and have done very well, and a couple of them have $150 million portfolios that they're managing now because they know the space so well and understand the industry. A little different in our situation but fairly similar to what Brian mentioned.

MS. ELLIS: Sounds like the way we view training here at the FDIC. Nothing like experiencing a crisis to learn a lot.

Before I open up the questions for the audience, I want to ask, again, our bankers one more question, and it's about this concept of liquefying shares, which you both touched on and we've heard about in at least one, maybe two panels earlier today—and you guys talked about how you've addressed that problem. Is this a challenge that has become more urgent, or is it more difficult post-crisis? Why are we hearing about this now, or has it always been a problem and we're just now focusing on it?

MR. RILEY: I think the problem has always been there. At some point in time in an organization's evolution, you're going to reach a stage where the original founding shareholders may want to not be a shareholder, and so that need just arises. We're now 25 years old. You can imagine that folks that invested when they were in their 40s are now in their 60s, or they invested when they were 50 and now in their 70s. It becomes an issue of needing cash heading into retirement or for estate planning needs. In terms of challenges, I think it's probably less difficult with a widely held bank than it is with a narrowly held bank, because typically in a narrowly held bank those types of solutions generally mean the sale of the institution.

MR. SCHNEIDER: I think, as Brian mentioned, it probably has been a problem for quite some time in the banking space, especially the privately held organizations. One of the motivations for the business bank in Appleton to sell to us was shareholder liquidity. They were reaching some of the same age demographics we had with our shareholders before we took it public and kind of forced a sale at that point in time.

Prior to us taking the company public, I think some of the things you can do are to try to be out promoting your stock and promoting your company. We did have a fairly short buyer/seller list that we had created to try to create opportunities for sales to be transacted, and that was another means for us to create shareholder liquidity longer term, but we do think with our public company status and our inquisitive nature that there's an opportunity for us in the future with other organizations that are having the same challenges.

MS. ELLIS: Okay. We have plenty of time for several questions. If you would like to ask a question, again, we'd ask you just to go to the microphone.

While people are thinking about a question to ask and wandering over to the microphone, I think I'll toss Rich another question. What are you thinking of in terms of follow-up research on the data that you have, the new survey data you have on ownership structure?

DR. BROWN: I'm glad you asked that. It's one of the first things that we've wanted to look at is attrition over time. These institutions are fairly successful in real time, but over time are they going to remain independent over the long-term at a greater rate or less of a rate than the widely held institutions? That's one of the things we want to investigate. It's going to take some time. Our survey was done just about a year ago, and so we're going to have to follow them over the next couple of years and compare the rate of attrition between the closely held and the widely held and see if there's anything there, and hopefully it will give us an opportunity to make that comparison.
That's probably number one on our agenda. I think following performance going forward as well. We should also consider the opportunity to go back to examiners at some point in the future, maybe look at other parts of the country. We were very focused—this closely held ownership structure is very predominant in the middle of the country. It's probably less so in the coastal areas, a lot more new institutions, for example, in the Southeast and the West Coast, and I think looking at this same issue in other regions might be something that we should follow up on as well.

MS. ELLIS: So stay tuned for more research.

MR. PAPE: I'm Don Pape, Republic Bank, Norman, Oklahoma. Question for Tim. Does somebody make a market in your stock so you really have liquidity in it?

MR. SCHNEIDER: Baird was our primary lead on our offering, and they're making a market in our stock. We also have Stevens out of Little Rock, Arkansas, and as well, recently, Maximum and Raymond James have started to make a market in our stock as well.

MR. PAPE: Okay. Thank you.

MS. CALABIA: Chris Calabia again from the New York Fed. One of the interesting themes that's come up today is the role of millennials both as customers and as employees, and I'd be interested in hearing from Brian and Sorin what makes millennials different as leaders and how can we best leverage that skill?

MR. RILEY: The first item I have learned in terms of millennials is the preferred method of communication. I'm generally texting staff at 8 or 9 o'clock in the evening, because they're working on a problem and they need access or they'd like to have an answer. This has become one of the most effective tools.

I've also learned that the long windy emails or memos are not effective with the millennials. It needs to be quick bullet points, let's do this, do that. But in terms of leadership style, I think the millennials are perhaps more empathic than we are being, the baby boomers or generation X. They're also more collaborative, which I think is going to make them incredibly effective going forward because so many of the challenges that we face as an industry require collaborative answers. And I really do think once we can unlock that talent level within our organizations and the ideas, some really interesting and good things are going to happen.

DR. SORESCU: I agree with everything Brian said. We've seen our students sometimes sitting at the same table working on a project and communicating through text to each other instead of talking. Collaborative leadership, definitely. Empathy, definitely. I think sometimes we hear from employers, we don't see it that much, certainly not with the students that we recruit for this particular program, but we do hear of a certain sense of—I don't know whether entitlement is the right word—but the sense that certain things have to happen just because they went to school, and one of the soft skills that we're trying to teach is that they really need to earn their place in the society. And we're not always successful. Occasionally we hear that they show up at the first annual review and they ask whether their parents can attend. It's gotten past the point where they come to see me with their parents. Now they want to go to the first annual review meeting, and we're trying really hard to put an end to that, and those are the type of leadership skills we're trying to teach, most of the time successfully. No, your mom cannot come.

MS. ELLIS: What role—Sorin or anybody else, but maybe Sorin knows best—what role has the consolidation industry and particularly cost cutting of entry-level training programs at the regional banks do you think have had on overall training programs?

DR. SORESCU: I missed the first part of the question.

MS. ELLIS: We've heard anecdotally that consolidation of the industry has caused a lot of regional banks to drop what used to be entry-level or management-level training programs for commercial banks. I'm wondering what role that plays in this overall gap that has been created, that was identified for you.

DR. SORESCU: I don't know if the gap is due to consolidation in the industry. We talked before the session about lack of training. In my conversations with the advisory board, they represented to me, and I don't know, I'd like to hear opinions from others, that the reason for the gap is that there was a time during the 1990s when people who would normally now be in their 40s, they're simply not interested, maybe late 30s, early 40s, simply not interested in working in the industry at all. They went to work in different industries. And what was represented to me is the reason for the gap is essentially the fact that the mentality has changed and there was a shift in terms of what is viewed as prestigious and what is not viewed as prestigious as opposed to consolidation. If anybody else has a different opinion as to what is the cause of this talent gap, I would like to hear it.

MS. ELLIS: Please share.

MS. GARUFIS: My name is Janet Garufis. I'm with Montecito Bank and Trust. I spent most of my career with systemically important banks, and one of the jobs I had was to create business banking for Bank of America and Security Pacific. And one of the things that happened in the 90s, yes, these people left banking, but because we changed the way we did banking, and we didn't need those people as much anymore, and we asked folks to go to the big C&I, corporate banking, and all of the other kind of lending was left to be done basically with credit scoring, and there was a huge gap in between, and we didn't train anybody to do it. There was nobody doing that business, and there was a lot of consolidation, and those jobs were eliminated, many of them. So I think that had to have created some of this gap that we're seeing now in addition to the fact that the big banks stopped training people, except for corporate banking level.

MS. ELLIS: Interesting. Thank you.

DR. SORESCU: I would completely agree. I think the big banks have changed their business model to where the lending decision is a lot more quantitative and automated. The community banks, as far as I can tell, have not changed their business model. There is still the need for somebody to understand the community, but I don't think they're telling their story very well in terms of what they have to offer as a career path, and we have seen, and we see even as early as a few months ago, a student whose dad I know very well who got a job with a major bank, realized that this is simply not a fun career because you get to work on something very specific and it's very small, and you're a small part of a big picture and left it to go work for a community bank and is much happier. We see some of that transition happening, but I don't think the industry as a whole tells its story very well, and our program helps tell that story somehow.

MR. RICCA: Hello. My name is Mark Ricca from First American International Bank in New York, and my question is for Sorin, and it's a three-part question with the second part being the most important. Not that big a deal, though. It's easy. The first is about how many students are in the program. The third is where do they go when they graduate? And the more important question, though, is what attracts them to come to that program? What's the secret sauce that you have that's getting people to come there? About how many, what attracts them, and then where do they go when they're done?

DR. SORESCU: All great questions. We graduate about 30 students per year from the program. There's a demand for probably twice as much, which is a current unmet demand, so it doesn't mean there's not more. Certainly, if we wanted to expand, we could expand more. We have a little bit of a gap there, which is why we're trying to expand the program.

When they graduate, as I said earlier, the majority of them go work in commercial banking for firms who are members of our advisory board, simply because if they have an internship and they like it and they get a job offer, that essentially seals the deal.

The secret sauce, that's a great question. Here's the secret sauce. As a state university, we have a—you're familiar with the term I'm sure—"dual mandate." The one mandate is to service the population of the state of Texas. The other mandate is to provide excellence in teaching to perhaps a subset of our student population who are the highest achievers. We created in the department a series of programs, all specialized programs. Banking is not the only one. We have trading, risk management. We have investment banking. We have private equity and venture capital. We're working on others. But we created a small set of programs for the highest achiever students to make them feel that they get a quasi-small school, private school type experience, and this is the second part of our dual mandate, if I may. And for a number of our students, this is incredibly important. There is a sense of belonging. There's a small group. They know each other. They always hang together. They like that type of experience which otherwise you would not get in a big university, and I think that is exactly the defining ingredient of all of our specialized programs, of which commercial banking is one.

MS. ELLIS: Are there any more questions for any of our panelists? Well, seeing none, please join me in thanking our panelists today. And I want to thank you all for your great questions. The whole day has been a thoughtful discussion on a range of topics that we hope will point the way for additional research that will prove valuable to both community banks and the regulators. We look forward to beginning that process as we assemble conference proceedings in the coming weeks. So be sure to look for that.

Before welcoming back Chairman Gruenberg for closing remarks, I'd like to encourage you to fill out your evaluation sheets that are in your binders. We would really like to hear from you about what your thoughts are on this conference. There'll be a box in the back where you can drop them off or you can leave them on your table, but if you wouldn't mind taking some time to fill them out, we'd be most appreciative.

At this point I'd like to welcome back to the podium FDIC Chairman Gruenberg, who will make a few closing remarks.