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SPOTLIGHT:
BANKING AND FINANCE

Community banks having tough time filling boards

Personal liability risks scaring away candidates

BY BRETT JOHNSON

Teachers, doctors ... sometimes even a local contractor.

When it came to community banks' boards of directors, all types were walking through the doors.

Not anymore.

There's a mass shuffle for the exit occurring these days, as the scrutiny on directors has increased alongside liability risk, seemingly making nuanced banking expertise a requirement. And even having such knowledge doesn't altogether mitigate the anxiety.

FinPro Inc. CEO **Don Musso**, whose bank consulting firm is intimately familiar with all the industry's protocol, said he's on the verge of resigning as director of **Millington Savings Bank** due to fear that he could be held accountable if something goes awry.

Musso said that, historically, all directors in the industry were protected by the so-called prudent businessman rule. This means that as long as you looked at a problem, analyzed it and made a decision based on the available data — you were protected. Being sued required

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READY FOR LIFT OFF

Schindler Elevator feels its technology has it primed for growth

BY TOM BERGERON

Schindler Elevator Corp. is a $10 billion international company with its U.S. headquarters in Morristown. As one of the big four in its sector, it installs, maintains and repairs both elevators and escalators.

But if you think the business is only about getting people from point A to point B, you're mistaken.

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Jerry Piserchia, left, senior project manager, and Greg Ergenbright, president, Schindler Elevator Corp. -AARON HOUSTON

Condos making comeback in Jersey

Class finally recovering in state's prime locations

BY JOSHUA BURD

The financial crisis brought New Jersey's for-sale housing sector to its knees — and developers of luxury condominiums were among the hardest hit by the meltdown.

But some builders are slowly coming back to the asset class, experts say, driven by the demand for high-end units in the state's prime locations and the sheer lack of supply after many projects were put on hold or converted to rentals during the downturn.

"The demand is unbelievable," said **Martin Brady**, executive vice president of sales and leasing for **The Marketing Directors**. The New York-based real estate consulting firm has several condo assignments in North Jersey, including The M at Englewood South in Englewood and Trio in Palisades Park.

"We have open houses on Saturday and Sunday and it's like the old days — we'll have seven or eight people in the sales office at one time."

That demand is one key reason developers are planning or rebooting condo projects in some of the state's most attractive markets, which in recent years have been dominated by rental apartment construction. Take Jersey City, where developer **China**

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LIABILITY

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willful misconduct, or gross negligence.

This is changing.

"The FDIC is trying to get rid of that willful part, changing it from gross negligence to ordinary negligence," said Musso, whose firm is based in Peapack-Gladstone. "As a director of a bank, I'll tell you that's just not acceptable. People are starting to look at this and change board behaviors for the worse."

Despite New Jersey remaining at a safe distance from the nation's 149 failed institutions and the roughly 1,200 bank directors sued by the FDIC since 2009, experts are making it clear that directors' personal liability worries have become a hot-button topic everywhere.

A survey released last spring by the American Association of Bank Directors found that 25 percent of banks around the nation have within the past five years had a director resign out of fear of liability, or had a prospective new director refuse the position for the same reason.

And if it's tempting to think that because no banks headquartered in the Garden State have directors worrying themselves with financial crisis fallout, let the more than 100 attendees at a recent director liability training session held by a state industry group tell the story.

John McWeeney Jr.

John McWeeney Jr., CEO and president of the NJ Bankers, said there was very little interest in this topic 10 years ago. The veritable cricket chirping of the organization's early workshops has been replaced by the sound of record attendees.

Directors' increased interest in learning how to cover their bases was echoed by Musso, who has been hosting education sessions for the directorate at community banks.

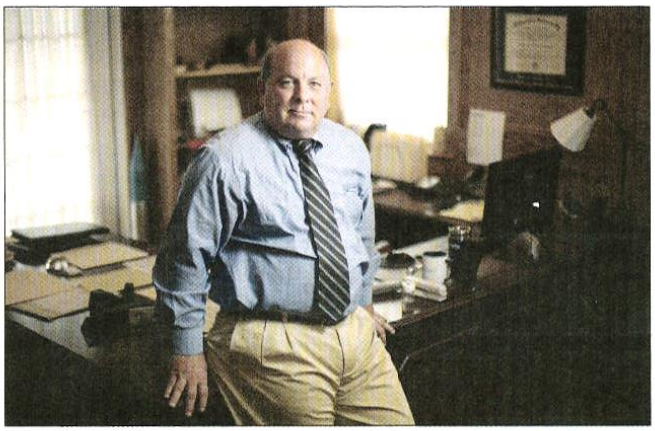
"This is definitely something people are actively seeking out — it's more than just a necessary evil," he said. "It's all being driven by the FDIC and them suing failed institutions and their directorate for remuneration of problems that caused bank failures."

Musso said this hesitation can be bad for business in a number of ways. On his board, a number of current board members are hesitant to approve new loans.

And Musso doesn't blame them.

"On the board I serve on, I know that I'm less willing to give any concession," he said. "If that loan goes bad, I could be liable for it, so I'm not going to bend at all on loans. And I think this might lead to less and less lending going on at community banks."

Most of the lawsuits filed against directors by the FDIC have been tied to the approval of individual loans by directors. This has particularly come to bear at small community banks, where directors take on the loan-related responsibilities that rank-and-file staff might at bigger banks.



Don Musso is the CEO of FinPro Inc., a bank consulting firm. -AARON HOUSTON

"By reading those complaints, it's clear that (the FDIC is) putting directors in the shoes of a loan officer, even though they might have no background in lending," Musso said. "They're community members from various backgrounds. But they're certainly not bankers."

The community-centric nature of these boards was why they got involved in the process, he said. Since the likelihood of somebody knowing who was getting that loan was pretty high, it was thought this familiarity subtracted some of the risk. Therefore, they approved loans regularly.

David Baris, president of the American Association of Bank Directors and a lawyer in a Washington, D.C., firm, has used his national platform to promote a new message — one that goes against that traditional way directors have operated:

"We have advised boards of banks to not approve individual loans. Rather, they should oversee the process; they ought to hire qualified credit and loan officers and provide a written loan policy," said Baris, a partner at **Buckley Sandler**.

He added that these loans can come back as the FDIC's targets for individual liability if the bank ends up failing. Nearly half the time when a bank fails, the directorate is sued.

But that's only to imply engaging in loans should only be avoided when a failure seems imminent.

Most bank boards never really know when the bank is failing prior to it happening, Baris said.

Given all this, the role of a director has evolved over the past few years. That's reflected in what community banks are looking for in additions to its board today.

McWeeney hears this from his association's member banks as they look for new directors.

"As the responsibilities are greater, and as they're exposed to greater liabilities, banks are looking for directors with an accounting, finance or legal backgrounds, or someone who works in risk management," McWeeney said. "They want expertise."

And that, he said, can be a good thing.

"Part of this was (the financial crisis fallout)," he said. "But, to be honest, I think the bar was being raised over time anyway."

But, as the bar rises, it inevitably becomes harder to source new bank directors.

And, according to Musso, even those with the talent aren't necessarily eager to join boards.

"People tell us that they don't want the liability," he said. "They'd just rather not serve on a board. It's making it hard for us to attract new talent.

"Banks need a well-diversified, market-driven board of directors. Anything that will cause that to dissipate is not going to be for the industry's better."

Knowing how little you know

Maybe being a total expert is too much to ask a director, who has a whole other professional life.

But, as **John McWeeney Jr.** of NJBankers will tell you, "You still have to know enough to ask questions." He laid out the issues that should be at the fore of a director's mind:

- MERGER AND ACQUISITION RISK "There's a lot of consolidation going on in the industry. It's something that's discussed quite frequently, when it's the right to time to acquire or be acquired."
- CYBER-SECURITY/FRAUD RISK "This is a whole new area that banks are worried about, and it's becoming a bigger issue by the day. Directors should be worried about it, too."
- INTEREST RATE RISK "This has been a risk for a while. Everyone is waiting for when the interest rate is going to rise. No one wants to be holding loans that are under water."
- REGULATORY RISK "Always the most important: making sure that you're doing things in conjunction with what the regulators require. Directors can occasionally get in trouble because they don't comply with the bank's secrecy act, or things of that sort."

Going to bat

It was back in 1989. Congress had just passed a law that created provisions for enforcement powers against bank directors.

David Baris was a lawyer representing banks; his friend was a director. Their conversation served as the impetus for the creation of the American Association of Bank Directors.

"He asked me, 'Who is representing the bank directors? There's plenty of associations protecting the bankers,'" Baris said. "I said, 'No one is.'"

The nonprofit that came out of that short correspondence became the only group out there that advocates for individual bank directors, something that's more important now than ever.

The banks that aren't having to scramble for new directors are tightly holding on to what they've got.

Thomas Shara, CEO and president of Oak Ridge-based **Lakeland Bank**, said he's been lucky enough to stock his community bank's board with core directors who have stayed with Lakeland for years.

Keeping the same directors for years makes education all the more important.

"The rules keep changing; we've done intensive training for our directors on regulatory change as it comes about, which is fast and furious," he said. "It's a never-ending educational piece that we're continually doing for our directors."

Shara often sends his directorate to educational programs held by NJBankers, as well as other associations.

"You really have to," Shara said. "Keeping your directors up to date on this stuff through education is essential."

But change isn't the only dynamic at play.

Musso said that what he's telling directors about liability hasn't actually changed much over the years — just the perception of it has.

According to the FDIC's annual reporting, it recovered more than $674 million from professional liability claims and settlements just in 2013.

Even if it's happening elsewhere in the country, watching directors get sued for millions has been a good enough incentive to pay more attention here.

"Directors are just way more willing to learn now, and more engaged," Musso said. "It's like they're more sponges now than rocks."

Though it could be traced back to a certain endemic anxiety, the consequence of this new commitment might at least have one positive aspect.

"Here's the bottom line: What's happening is the boards are getting stronger," McWeeney said. "The education that's become so important for directors makes it so that they're able to add more value at banks."

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