“We’re different. Our name on a building is not as important as the name of the banker meeting with prospects”

– Joe DePaolo, CEO

THEY BRING THEIR "A" GAME EVERY DAY

Signature Bank's model has held up remarkably well over a 15-year run-up to $33 billion. How far can it go?

By Bill Streeter, editor & publisher

For big-bank CEOs reading this story, here are two takeaways up front: 1. If you shoot hoops with Joe DePaolo, and play his game, you'll lose. 2. If you compete with DePaolo's bank at its game—relationship banking for private, urban middle-market companies—you'll lose. Interested in knowing why?

You'll notice something about Joe DePaolo's office at Signature Bank—after you take in the view of the Empire State Building looking down Fifth Avenue. The walls are bare. The president and CEO keeps photos of his family on a bookshelf and behind his desk. But no artwork, testimonial plaques, degrees, etc., are hanging on the walls.

"I keep my walls bare to remind me I'm a visitor here," says DePaolo. "I don't want to get too comfortable."

Spoken like a coach of a sports team whose success can be fleeting. For a time, DePaolo, one of the founders of the bank, considered high school coaching as a career choice. He was a point guard on his high school basketball team. In college, he chose accounting over coaching, which led to a banking job at New York's Republic Bank (since acquired by HSBC Bank) and then Signature Bank.

Despite that switch, DePaolo, who grew up in the New York City borough of the Bronx, has always kept his love of basketball. For his 50th birthday, his wife arranged to have him meet and play ball with New York Knicks legend and Hall of Famer Walt "Clyde" Frazier. The two men hit it off.

When it came time to play, DePaolo knew he couldn't beat Frazier playing one-on-one, so he suggested they play "HORSE." In this game, each player calls the shot he will make—often a trick shot. If he makes it, the other player has to match it or he "earns" the letter "H," etc.

Frazier agreed. What he didn't know was that DePaolo can shoot "lights out." The banker took two out of three from the seven-time All-Star, who, although 70, remains in good shape. "Frazier has told people about it," DePaolo says with a grin, adding that the two of them have stayed in touch.

The story is an apt analogy for what Signature Bank has done over the last 15 years. It has played on the courts of the big New York City banks, played its game, and won hands down.

BANK OF TEAMS

In post-game interviews with star athletes, they always say that winning is a "team effort."

It's very much the same at Signature Bank, where in interviews and annual reports, management talks about the team. Except that in this case, it's not the team, but the *teams*—all 97 of them, as well as the folks who support them. These "Private Client Banking Teams" are, in fact, the keystone to the bank's incredible success, growing from startup in 2000 to $33 billion in assets, and currently on a run of 25 consecutive quarters of record earnings. The bank was profitable within 21 months, went public in 24, and repaid its initial $42.5 million capital infusion from Bank Hapoalim in just four years. From that point, Signature Bank has never looked back, including during the financial crisis when it never even had a down year.

The bank's modus operandi—acquiring teams of bankers from much larger banks—is no longer novel. (Some investment bankers refer to such a "team liftout" now as the "Signature model.") And while Signature Bank's three founders likely were not the first to apply this practice, they have certainly perfected it. Each team operates as a quasi-independent, single point of contact for Signature Bank's middle-market clients.

SIGNATURE HIGHLIGHTS

Full-year 2015 over 2014

TOTAL ASSETS
$33.45 billion
up 22%

DEPOSITS
$26.77 billion
up 18.4%

NET INCOME
$373.1 million
up 26%

LOANS
$23.79 billion
up 33.2%

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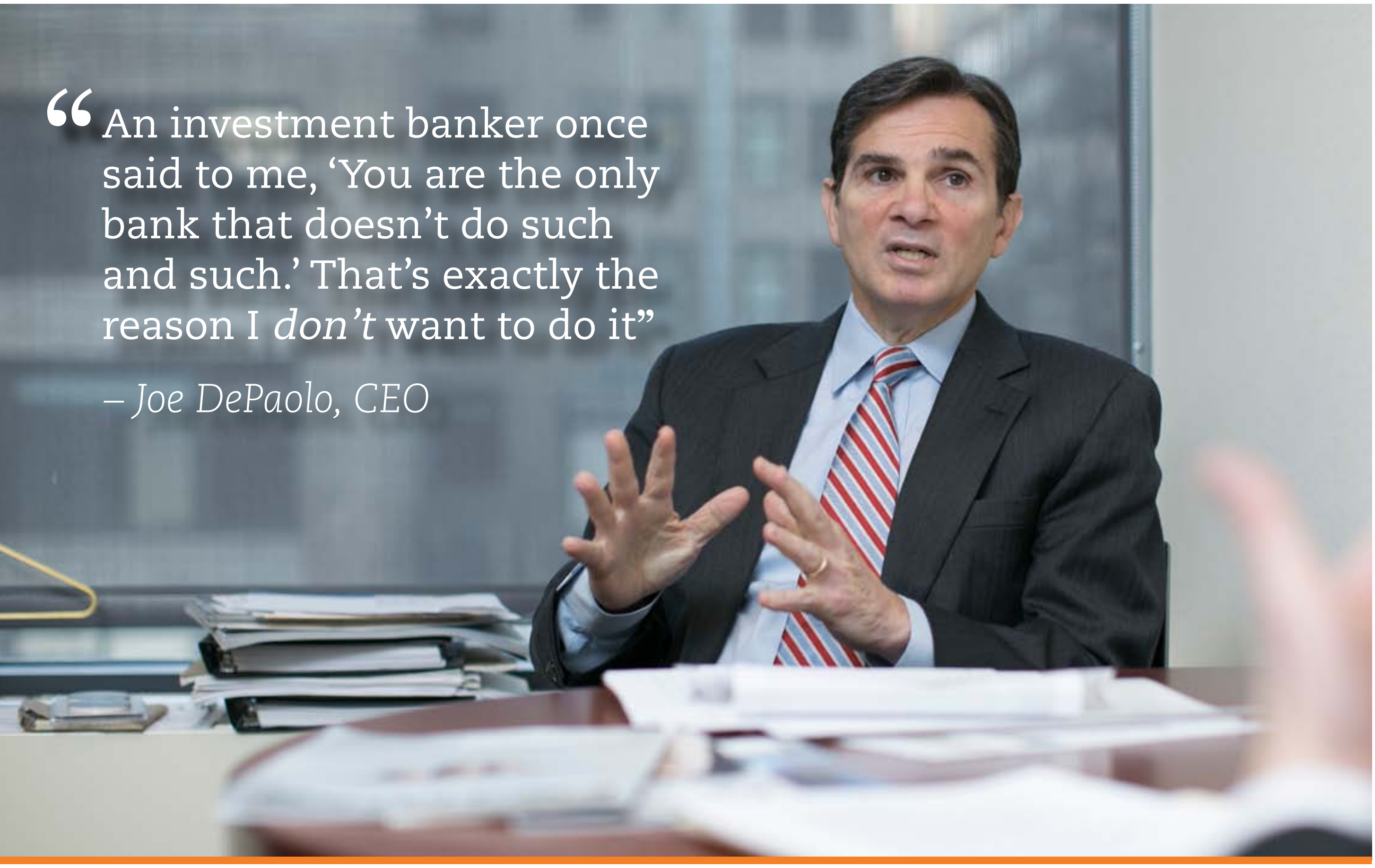

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>
> *– Joe DePaolo, CEO*

One of several remarkable things about the bank is that in its run-up from a niche de novo to a $33 billion-assets institution, it has not changed the fundamentals of how it operates.

Hiring people from big banks is a long-standing tradition at small and midsize banks. What makes it work so well at Signature Bank is that the practice is combined with a singular focus on client relationships; a balanced, simple incentive compensation plan; disciplined underwriting; and a minimum of middle management. The result is highly appealing and very sticky to both employees and clients. (See “Inside Signature Bank’s playbook,” opposite, for more details.)

Now, as it prepares to operate in the world of systemically important financial institutions, the question is: How long can this bank’s remarkable run continue?

FIRST, GET *THEIR* MONEY

Signature has, from the get-go, been a bank that puts its depositors first. Though management doesn’t explain it this way, the bank operates as if there were not deposit insurance. “We don’t worry about making ten extra basis points on yield or on loans,” says Chairman Scott Shay. The bank has always been, as he says, a “sleep-at-night” bank.

The bank is highly capitalized, and delinquent loans are few (see accompanying highlights chart, p. 18).

In a 2008 interview, DePaolo explained, “Everyone thinks of banking as lending. I think of banking as bringing in deposits. If I have to give you money, it’s easy to bring you in as a client. If I have to *get* your money, it’s harder. Fundamentally, our belief is you build the bank for the deposits.” This view has not changed. The bank’s incentive compensation plan actually gives more credit for deposits than for loans.

What *has* changed is the amount of lending the bank does. As Shay explains, the last thing they wanted to be as a startup was the “lender of last resort”—booking credits no one else wanted. So they were deliberate in lending, investing excess deposits in conservative investments. Signature lost quite a bit of money at first, but not from bad credits. Once management embraced commercial real estate lending in 2007, the loan portfolio grew quickly: from 17% of total assets in the early years to about 40% in 2008, and to 71% now.

According to DePaolo, they made the decision to get into commercial real estate lending (but not construction lending) because the banking teams were saying they had clients with real estate needs that the bank couldn’t meet.

The bank took the plunge using what has become its “signature” method—lifting a veteran team from a much larger bank. In this case, it was North Fork Bank, which had been acquired by Capital One the year before. Since then, CRE lending has become the biggest component of Signature’s loan portfolio at about 78%, with 48.9% multifamily and 28.9% other CRE.

Shay says that, in general, Signature’s most typical CRE customers are multitenant properties. “We do nothing that’s not cash flowing,” he points out, “and our real sweet spot is multifamily apartment complexes in the boroughs [the five counties that comprise New York City]."

The bank's average loan size, including CRE, is $4.5 million.

"We're not trying to finance the World Trade Center or the General Motors building," says Shay. "We're generally financing buildings that people live in, that have lots of tenants and cash flow, and don't have any singular risk."

By contrast, he explains, the bank hasn't done construction loans in a long time because they're not cash flowing.

"We don't feel like we're getting a return that's appropriate for the risk depositors are taking."

Shay points out that one of his favorite sayings—one that helps him sleep—is that loan-to-value ratios don't pay back loans. Cash flow does. You begin to see the drift here.

"You can almost close your eyes to the interim values" on a loan to an apartment building with 150 units, says Shay. "It's going to pay you back."

LIMITATIONS AND LINE EXTENSIONS

Even though Signature's core strategy has carried it over the threshold of the top 50 U.S. banks, some analysts wonder if the strategy has an upside limit.

Responds DePaolo: "I think there are limitations if you go beyond the concentric circles that we build," referring to the gradual expansion outward from the New York City boroughs into the adjacent counties and states. "If we jumped to Chicago or Dallas, it would be hard to do business where the team reports to me or my senior management group in New York." DePaolo says that the bank would likely have to set up a similar structure in those cities.

But the numbers alone—asset size or number of teams—won't limit them, DePaolo maintains. He points out that while the strategy hasn't changed, how they implement it has.

"When we first started out, I had all 12 teams doing just about everything through me. As time went on, I became a log jam. So then we said if you have an operational issue, go to the chief operating officer, not me. For credit, they would go directly to the chief credit officer; for interest rate questions, to the treasurer."

Technically, 141 group directors are direct reports to DePaolo (there are 97 teams, but several have multiple directors), but he has Vice-Chairman John Tamberlane, the third of the bank's founders, and Executive Vice-President Eric Howell supporting him. And he brings in the human resources director and others as needed. "It's not as onerous as you think," he says.

The reason for that is because the group directors are all experienced bankers, not trainees or newly minted MBAs. They have decades of experience and don't need hand-holding.

"How am I supposed to tell someone, who's been developing business for 35 years and has a book of business the size of many banks around the country, how to grow his business?" DePaolo asks. "I'm there to remove obstacles."

Signature's CEO didn't tip his hand as to whether he has any plans to establish the model elsewhere. Although he did say that it could work in Dallas, Los Angeles, Philadelphia, Boston, Chicago, or any large city where big banks operate. But DePaolo may not need to take the show on the road.

First, there is plenty of business to tap in the New York metro area. Second, Signature has entered several niche banking markets over the past several years. These include equipment leasing and finance, asset-based lending, and municipal finance. These businesses operate nationally, and yet, in many ways, follow the same pattern as the rest of the bank—setting up shop and growing by acquiring teams.

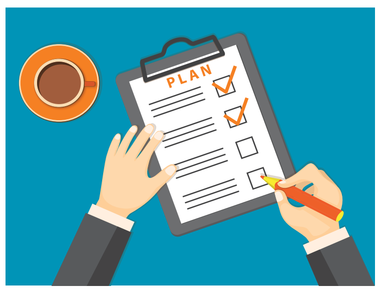
Signature Financial was formed in 2012 initially to engage in equipment finance and leasing. Team leaders had been telling management they were losing out on opportunities to do additional business with clients. For example, the bank handled the operating accounts of an ambulance company, but wasn't financing the ambulances.

As management studied the business over several years, they realized that to get the kind of returns they wanted, the operation needed nationwide scale. Eventually, they found a large team (55 people) that had been together for a long time and was willing to move en masse to Signature Bank. In 2014, Signature Financial expanded into commercial marine lending and franchise finance, again with veteran bankers brought aboard. The subsidiary then accounted for 12.7% of the Signature's loan portfolio in 2015.

Inside Signature Bank's playbook

Nine points sum up Signature Bank's winning model:

1. Target privately owned, midsize businesses (generally revenues of $5 million, or large deposits) for which a relationship with a bank is highly valued.
2. Provide a single point of contact for each private client business.
3. Acquire teams—called Private Client Teams—from larger institutions. (Typically, teams include an experienced business development officer and support staff.) The team brings clients with it, and "owns" them.
4. Teams do not underwrite loans. That's done by senior lenders reporting to the chief credit officer.
5. Each of the team leaders reports to the bank's CEO. There is no middle-management layer overseeing the teams.
6. Middle-management *expertise*, however, supports the teams in compliance, underwriting, cash management, technology, etc.
7. Incentive compensation for team members is based on the business their team develops (minus any that leaves). Each team has its own bonus pool, with no cap.
8. Support staff (tech, credit officers) receive subjective incentive compensation, based on an assessment of their performance.
9. Teams do not have assigned territories. They arrive with a book of business, typically based in a particular area. CEO Joe DePaolo says instances of team conflict over new business are rare.



"Raiders of the big banks"

The consolidation among New York City's large and midsize banks over 20 years has created a vast talent pool for Signature Bank. In these mergers, typically the big banks homogenized commercial private clients, rolling them into retail.

Team leads come from various sources. One is when the accountants and lawyers the bank works with say, "I know Bill and Joe are unhappy at XYZ Bank. You may want to give them a call." Sometimes, Signature's existing bankers know of former colleagues who weren't ready to make the move initially, but are now. Clients are another source.

In 2015, Signature brought five teams on board for a total of 97. Executive Vice-President Eric Howell and Vice-Chairman John Tamberlane meet with prospects first. Next step is to have the potential team leader meet with Signature's credit and cash management people. They have to feel comfortable that a much smaller bank can provide clients with the kind of services they need. If all that works, DePaolo meets them.

The word "acquired," used above, is apt. DePaolo and Tamberlane were involved in bank acquisitions at Republic Bank, but now avoid them. "We're bringing over businesses without buying the business," says DePaolo. Has the bank ever had one of *its* teams lifted? "Only twice, and neither book of business left the bank."

MORE SIGNATURE NUMBERS

	YEAR-END 2015	YEAR-END 2014
Nonaccrual loans to total loans	0.30%	0.12%
Allowance for loan and lease losses to total loans	0.82%	0.92%
Net interest margin	3.26%	3.29%
ROAA	1.23%	1.20%
ROAE	13.85%	13.81%
Efficiency ratio	33.64%	35.07%
CAPITAL RATIOS:		
Tangible common equity	8.65%	9.14%
Tier 1 risk-based	11.33%	13.49%

The bank added asset-based lending in 2013 with the addition of another team, and municipal finance and commercial vehicle finance in 2015.

Just so you don't think that everything it touches turns to golden earnings, Signature was one of several banks hurt by Uber's impact on the taxi medallion loan market. (Medallions, issued by municipalities, trade on an unofficial market. Pre-Uber, they could be valued in excess of $1 million in New York City; less elsewhere. Now, they have plummeted in value with few transactions.) Through the fourth quarter, the bank's chargeoffs have been small, though the troubled niche portfolio has pushed up its nonaccruals.

It was an unforeseen situation, DePaolo observes. No other medallion lender exited the business prior to the "Uber effect," he adds. "Something is always out there" that you can't anticipate.

INVISIBLE BANK

A couple months ago, DePaolo relates, "an investment banker said to me in a meeting, 'You know, you are the only bank that doesn't do such and such.' Everybody in the room that worked with me went, 'Oh no!' They knew that was the worst thing to say to me, because that's exactly the reason I *don't* want to do it."

Given that insight, it shouldn't be quite so hard to imagine a $33 billion-assets bank that has no social media presence. Granted, Signature is not a retail bank, but even many business-oriented banks can be found on Facebook or Twitter.

Signature is almost invisible to the public at large. Of its 29 offices, only a couple are at street level. The rest are on upper floors of buildings.

The bank does no advertising, except in support of a client, according to DePaolo. Signature's name on a stadium or a building? "Waste of money." Radio ads? "They all sound the same."

"We do things differently from others," says DePaolo. "That name on a building is not as important as the name of the banker that is actually meeting with prospects, so we have no line on our books for advertising."

Signature does have a web page, but not social media.

"With the clients we target [private middle-market companies], and their families—even the younger members—it's meeting face-to-face" that's important. "It's letting them worry about their business and letting us take care of the banking and financial side of it."

DePaolo has not closed his mind to social media, however. "I don't want to have blinders on," he says. The bank will adjust, if necessary, he adds, as it has in other areas.

DePaolo has a healthy paranoia about cyberfraud, and believes that social media would only expose the bank more than it already is. As he says, "There are thousands of 15-year-olds in their basements saying, 'Okay, let's attack this place.'" DePaolo doesn't want to give them any more reason to do it than they already have.

When it comes to Kabbage, Lending Club, and other non-bank marketplace lenders, some of whom are active in business lending, DePaolo is up to speed on what it is that they do. But given his client base, he doesn't see it as a threat at this point.

"I'm not trying to stick my head in the sand, but I know our clients," maintains DePaolo. "They're a little bit larger than small business, and they want to be able to touch and know that there's a human involved, even the next generation. So we're watching the landscape rather than leading the landscape. Where we do lead the landscape is in service and in growing, but I don't think we're going to lead in technology."

BIGGEST CHALLENGE

Given his concerns about cyberfraud, you may think that issue is DePaolo's top concern in 2016. It's not.

The biggest challenge "without a doubt," he says, is compliance as the bank has grown.

The bank has been preparing for the $50 billion Dodd-Frank threshold for some time.

"We don't want an expense in any particular quarter or year that's so out of range, so we've started building now," DePaolo says.

The bank brought in a consulting firm to help it get ready for DFAST (Dodd-Frank Act Stress Test). It also had the consultants look at the organization from a risk perspective in terms of getting ready for CCAR (Comprehensive Capital Analysis and Review) requirements that kick in at $50 billion.

Of this preparation, DePaolo says: "It's costing us millions."

NO POTTED PLANTS

Signature does keep a low profile in many ways, including lobbying. Chairman Shay takes the lead here, and his efforts mirror the bank's core operating principle—relationships. Over Shay's career, which included working in private equity with Lew Ranieri, he has met many government officials. In fact, he first met Barney Frank in 1990 and was very impressed with the former congressman's intellect.

Fast forward to 2015, when Signature announced the appointment of Frank—cocreator of the Dodd-Frank Act—to its board.

"There was about 15 minutes of people thinking we were crazy," DePaolo admits. Since then, he says, many people have called to say what a "brilliant move" it was. Their thinking, he says, was, "How better to see the costs and effects of the law and what needs to be changed or doesn't than to have the person who wrote the law on your board."

This was not the first former member of Congress to join the bank's board, however. Former Sen. Alfonse D'Amato has served on the board for ten years. So Signature has two former Banking Committee chairmen as directors.

The Signature Bank founders, says Shay, want their board to be "a hot court"—a legal term meaning, where the judge asks lots of questions.

"We want smart people," says the Signature chairman. "We don't want a potted plant. We want engaged, active members who can see risks and warn us off if they see a risk we missed." ■

"We don't worry about making ten extra basis points on yield or on loans. We have always been a sleep-at-night bank"

– *Scott Shay, chairman*