

**REGULAR STATE BANKING BOARD MEETING
HELD BY CONFERENCE CALL
OFFICE OF THE COMMISSIONER
DEPARTMENT OF FINANCIAL INSTITUTIONS
2000 SCHAFFER STREET, SUITE G
BISMARCK, NORTH DAKOTA**

September 26, 2002

The regular meeting of the State Banking Board was held in the Office of the Commissioner, Department of Financial Institutions, 2000 Schafer Street, Suite G, Bismarck, North Dakota. Chairman Karsky called the meeting to order at 9:05 a.m., Thursday, September 26, 2002, by conference call arrangement.

MEMBERS PRESENT: Timothy J. Karsky, Chairman (*Office*)
Bill Daniel, Member (*Bismarck*)
Launa Moldenhauer, Member (*Bismarck*)
Roger Monson, Member (*Finley*)
Gary Petersen, Member (*New Town*)
Terry Zeltinger, Member (*Minot*)

MEMBER ABSENT: Ron Braseth, Member

ALSO PRESENT: Robert J. Entringer, Assistant Commissioner (*Office*)
Jeff Jungman, Chief Examiner – Banks (*Office*)
Chuck Youells, First State Bank of Sharon (*Aneta*)
Fred Manuel (*Pelican Rapids, MN*)

APPROVAL OF MINUTES

Chairman Karsky indicated the Board received copies of the minutes of the regular meeting held on July 18, 2002, and special conference call meeting held on September 5, 2002. **It was moved by Member Petersen, seconded by Member Moldenhauer, and carried by voice vote to dispense with the reading of the minutes and approve the minutes as published.**

FIRST STATE BANK OF SHARON – APPLICATION TO ESTABLISH A FACILITY AT 406 9TH STREET SW, COOPERSTOWN

Assistant Commissioner Entringer reviewed his Memorandum dated September 24, 2002, with the Board. Notice of the application was published in the Griggs County Sentinel-Courier on August 30 and September 6, 2002, with direct notice mailed to three area financial institutions. No comments had been received as of the date of the Memorandum; however, one request for a copy of the application had been received from John Brown, Executive Vice President, Security State Bank of North Dakota, Hannaford.

Assistant Commissioner Entringer stated the statutory criterion as found in Section 6-03-13.3 was outlined in the Memorandum. The applicant notes current deposits in Cooperstown of \$1,302,826 and loans of \$2,214,750 as of June 28, 2002. The applicant is also projecting total deposits at the end of the first year to be \$18,100,000, with loans of \$9,050,000, growing to \$21,900,000 in deposits and \$10,950,000 in loans in the third year. The applicant also conducted a survey in Cooperstown showing support for the proposed facility. The survey shows 39 people from the Cooperstown community indicated their support of the facility. Assistant Commissioner Entringer noted the Department's determination that the establishment of the facility as set forth in the application demonstrates the convenience and needs for the proposed location.

The second criterion for the Board to consider is the financial strength of the bank in relation to the cost of establishing and maintaining the separate facility. The applicant indicates the facility will be leased; however, the building is not under construction at this time and a copy of the lease is to be forwarded when signed. Annual rent projections are estimated to be \$20,000 and the applicant indicates the lease will not be capitalized on the bank's books. The financial projections included under Section V for the first three years show the applicant is expecting a net loss for the first year of operation; however, is expecting a small net profit by the end of the second year of operation.

The third criterion is whether any bank would be seriously injured by approval of the application. As noted earlier, no comments have been received, nor has any opposition been indicated as of the date of the Memorandum. It is the Department's determination the lack of any stated opposition demonstrates there will be no serious injury to another financial institution.

Assistant Commissioner Entringer noted that President Chuck Youells had faxed projected capital ratios for the end of the first, second, and third year of the operations. President Youells is projecting capital at the end of the first year to be 7.2%, at the end of the second year to be 7.7%, and at the end of third year to be 8%.

At this time President Youells was asked to discuss the application, as to the reasons for entering the Cooperstown community. President Youells indicated at the present time they have so many customers in Cooperstown that have to drive to other locations; therefore, it would be more convenient for them to have the facility in Cooperstown. He indicated the bank presently has 163 customers in the Cooperstown area, going as far south as Hannaford, up along Highway 200, and the Cooperstown facility would eliminate a 45-50 mile drive for these customers. President Youells indicated a lot of their customers in the Hannaford and Carnac area are getting deprived of agricultural help, as the other banks located in Cooperstown do not seem to understand cattle operations. He stated these individuals are good loan customers, but are being pushed out from the other banks. President Youells stated they believe there is a need and can provide the help in the Cooperstown community, especially regarding agriculture.

Chairman Karsky asked President Youells whether the bank was going to have \$18 million in deposits at the end of the first year. President Youells stated that is their projection after one full calendar year. Chairman Karsky asked if that seemed aggressive. President Youells responded he did not believe so based on the Call Report information of the deposits from the other banks in that county. Since he currently has \$2.5 million of the deposits from that area, President Youells stated he feels that could increase at least \$15 million. President Youells explained there is rotating of school funds; the bank already has a lot of the county money; and there are loan customers with nice deposits that are willing to switch their accounts to the bank right now. Chairman Karsky questioned the current size of the main bank in Sharon, and President Youells indicated it is currently \$43 million. Chairman Karsky noted with the current total assets of the bank and the projected growth it would be significant growth for the bank, to which President Youells agreed. Chairman Karsky stated the Department believed the projections were extremely optimistic and that is why Assistant Commissioner Entringer asked for more information on the projections in July, as well as what effect this would have on the bank. Chairman Karsky stated these projections are very aggressive considering that in the past banks have left the Cooperstown community because there was not enough business for two banks, such as when Farmers and Merchants

Bank sold out to Community First Bank, and now this would be the proposed third bank in Cooperstown. Chairman Karsky stated as far as loan volume the bank is not projecting a great deal the first year, nor does it increase much throughout the second and third year. President Youells indicated he felt the loan volume would level off quickly.

President Youells continued that in an average year the bank takes applications from two to three borrowers per week and although they are not all bankable, it is fairly consistent.

Chairman Karsky asked about the crop conditions in the Sharon/Aneta area, and President Youells indicated the area had just the right amount of rain and the crops were looking good.

Chairman Karsky stated it has been one year since the last examination of First State Bank of Sharon and the Department is not sure of the condition of the loan portfolio, and wanted to make sure that the bank would not be jeopardizing itself.

Member Petersen asked if Sandra Ueland would be the manager of the Cooperstown facility and whether she had lending experience. President Youells indicated Ms. Ueland would be the manager and does in fact have lending experience, as well as experience at Security State Bank of North Dakota, and has been employed First State Bank of Sharon for approximately nine years. President Youells indicated he would also be at the Cooperstown facility initially. He stated he recently hired Terry Kinneberg from Petersburg to fill his position at the Aneta facility.

Chairman Karsky asked who the building owners are, and President Youells indicated he and Ryan Iverson, the local funeral home owner in Cooperstown, would own the building. The building will be leased to the bank, the funeral home, as well as a flower shop. Chairman Karsky asked if the bank was financing the construction of the facility, and President Youells indicated he is presently financing the construction personally; however, they do have an application pending with State Bank of Fargo.

Chairman Karsky asked if the projections are met but margins are squeezed and the bank needs additional capital, if there was a contingency capital plan. President Youells indicated there was, which is to sell off stock and use personal

funds to inject into the bank. President Youells indicated he felt very confident in the projections and does not believe they will need to activate the contingency plan.

President Youells stated that he and Terry had reviewed the numbers again yesterday, and he is very confident that he can achieve the 25% of the market he is projecting in the application.

Member Zeltinger asked President Youells how the Binford facility is working out for the bank and whether he also spends time at that facility. President Youells stated he does go to Binford and rotates Tom as well as Terry in the Binford office. Member Zeltinger stated President Youells cannot be at all the locations at one time. President Youells stated the computer operations as well as some staff have been moved to Aneta; therefore Tom stays in Sharon and the staff in Aneta are rotating one day a week in Binford. President Youells stated Terry will replace him in Binford, and he will go to Cooperstown.

It was moved by Member Petersen, seconded by Member Zeltinger, and carried by a vote of 6 to 0, with Member Braseth absent, to approve the application by First State Bank of Sharon, Sharon, to establish a facility at 406 9th Street SW, Cooperstown.

FIRST SOUTHWEST BANCORPORATION – CHANGE OF CONTROL APPLICATION

Assistant Commissioner Entringer reviewed his September 24, 2002, Memorandum with the Board. He noted that the application was received on August 11, 2002, and published in the *Bismarck Tribune* on August 21, 2002, with the comment period ending September 3, 2002. Assistant Commissioner Entringer stated no comments or requests for copies of the application had been received. The Memorandum outlined the statutory criteria for approval found in Section 6-08-08.1(4). Assistant Commissioner Entringer pointed out that the proposal as described on page 2 of the Interagency Notice of Change of Control notes that Craig Larson is acquiring 24,081 shares of stock through a combination of gifting and purchase, raising his ownership to 42,683 shares of voting stock, or 42.27%. The shares are being acquired from Craig Larson's father, Franklin Larson, which is reducing Frank Larson's ownership from 31.26% to 18.69% of the voting stock as noted on page 4 of the application. Assistant Commissioner Entringer noted that

both of these transactions result in the need to file a change of control application with the Department; however, the Department chose to handle the applications simultaneously.

Assistant Commissioner Entringer stated the transaction is being financed via a bank loan for the down payment and an installment contract on the remainder of the purchase price. Included in the application is a confidential cash flow exhibit demonstrating Mr. Larson's ability to service the acquisition debt, as well as other personal debt via a combination of salary, dividends, and bonuses. It is noted on the August 20, 2002, cash flow projection that Craig Larson has excess available funds to service the debt in each of the five years of the projection period. The projected income for the bank through the year ending 2010 appears to be reasonable, and the projected dividends to net income are modest. Mr. Manuel notes in item 6 of the response to the Federal Reserve Bank that Craig, Franklin, and JoAndrea Larson control 77% of the voting stock of the holding company and, therefore, these three shareholders would be able to determine and declare the dividends necessary to enable Craig Larson to service his debt. This would be after considering the safety and soundness of the bank, as well as an adequate allowance for loan and lease losses.

Mr. Manuel also discusses the issuance of trust preferred securities in item 9 of the response to the Federal Reserve Bank. The issuance of these securities did not relate to this change of control, since the funds are not being used to effectuate the change in control.

Mr. Manuel was asked to explain the transaction to the Board and the information provided with the application. Mr. Manuel noted the applicants had received Federal Reserve approval on September 10, 2002, and the transaction could be consummated as soon as the State Banking Board approval was received. He stated the anticipated consummation date would be September 30, 2002. Mr. Manuel discussed the response to the Federal Reserve Bank and explained why the Federal Reserve Bank had more than the normal amount of questions with regard to this application. Mr. Manuel explained there were a number of things transpiring which precipitated the questions. The first question was the change of control application, but also the Federal Reserve Bank was analyzing the trust preferred securities to ensure they met the requirements to be qualified as Tier 1 capital, and this was the first time the Federal Reserve Bank was looking at the holding company since receiving a four-to-one stock dividend whereby the nonvoting shares were issued to the voting shareholders to the tune of four shares

of nonvoting for one share of voting. Mr. Manuel notes that the voting shares consist of about 20% of the holding company's capital. In order to get a lot of the numbers to flow, Mr. Manuel noted they had to do several things. First, they had to do an S Corporation analysis specifically for this transaction in order to determine the cash flows or distributions which they could make for tax purposes and then also for debt service purposes. Those numbers needed to flow into a book projection, which is the first part of the packet which the Board has. The book projection is the first part of the projection needed to analyze the safety and soundness of the bank, and Mr. Manuel noted in all cases the projections are a modest growth factor, a modest income, and based on history those items should be very easily obtained. The second part of the packet is the S Corporation analysis, in order that the applicant could calculate the cash flows and distributions to Craig Larson in order to service the debt. Mr. Manuel referred to the page titled First Southwest Bancorporation Shareholders, on which is listed the voting shareholders that shows Craig, Frank, and JoAndrea Larson own 77% of the voting shares. He stated there will be no change in the combined percentage. The thrust of the application is that Frank Larson is dropping from above 25% to below by a gifting of shares and the sale of shares to Craig Larson. Craig Larson's shares will go from 23.5% to 42.27% voting shares as a result of this transaction. The following page lists the nonvoting shares and when combining Craig Larson's voting shares and nonvoting shares, he will own approximately 22% of the entire organization. Mr. Manuel noted the cash flows the applicant is showing are reasonable and can in effect service the debt nicely with some excess cash flows available. Mr. Manuel noted the thrust of the application is that for years Frank and JoAndrea Larson owned 51% of the organization and there is a changing of the guard, whereby Craig has been running the organization for a number of years, which gives the organization some longevity.

Assistant Commissioner Entringer concluded that it is the Department's recommendation to approve the change of control application by Craig Larson to acquire control of the voting stock of First Southwest Bancorporation and the simultaneous application by Franklin G. Larson to reduce his ownership in First Southwest Bancorporation.

Chairman Karsky noted for the record that he had a conflict since his wife is employed by First Southwest Bank, Mandan.

It was moved by Member Daniel, seconded by Member Moldenhauer, and carried by a vote of 6 to 0, with Member Braseth absent to approve the

change of control application by Craig Larson to acquire control of the voting stock of First Southwest Bancorporation and the simultaneous application by Franklin G. Larson to reduce his ownership in First Southwest Bancorporation.

LINCOLN STATE BANK, HANKINSON – APPLICATION TO ESTABLISH A FACILITY AT 39 WILEY AVENUE NORTH, LIDGERWOOD

Assistant Commissioner Entringer reviewed his August 7, 2002, Memorandum noting the application was received on August 6, 2002, and published pursuant to North Dakota Administrative Code with the comment ending September 4, 2002. No comments were received and direct notice was also provided to Community First National Bank, Lidgerwood. The statutory criterion found in Section 6-03-13.3, North Dakota Century Code, was outlined in the Memorandum.

The applicant addressed the convenience, needs, and welfare criterion under Tab 5 of the application by indicating they currently have 120 accounts with approximately \$2 million in loans and deposits. The financial strength of the bank in relation to the cost of establishing and maintaining the facility is discussed under Tab 4. It notes the building is to be purchased and furnished for the bank wherein the applicant is estimating a total cost of \$90,000 to purchase, remodel, and equip the facility. The pro forma cost will not materially impact the financial condition of the bank as the current fixed assets plus the estimated costs to furnish the facility will represent 17.7% of the applicant's unimpaired capital, surplus, and undivided profits based on the July 31, 2002, financial information. The applicant's capital ratio as of July 31, 2002, was 10.4%, and the risk based capital ratios as of June 30, 2002, were 9.2% Tier 1 leverage, 14.24% Tier 1 risk based, and 15.5% total risk based capital ratios. The cost of maintaining the facility is addressed under Tab 7 with the future earnings and prospects. The applicant is projecting net income of \$90,100 the first year of operation, \$276,750 the second year of operation, and \$426,050 the third year. As of June 30, 2002, the applicant had a 1.6% return on average assets. The third criterion is whether other banks would be seriously injured by approval of the application. Under Tab 3 the applicant states they do not believe other banks would be seriously injured.

Management of the facility is intended to be a 27+ year employee of the bank, whose resume is found under Tab 2 of the application. Assistant Commissioner Entringer noted Greg Honl, Eide Bailly, LLP, had intended to be on the conference call; however, he was unable to be present. The applicant also submitted a number of letters from the Lidgerwood community indicating their support for the proposed facility.

Assistant Commissioner Entringer concluded by stating based on the criteria for approval, the applicant has demonstrated convenience, need, and welfare of the people in the community and area served; the applicant has the financial strength in relation to the cost of establishing and maintaining the proposed facility; and due to the lack of any demonstrated opposition, the Department would recommend approval of the applicant.

It was moved by Member Moldenhauer, seconded by Member Monson, and carried by a vote of 6 to 0, with Member Braseth absent, to approved the application by Lincoln State Bank, Hankinson, to establish a facility at 39 Wiley Avenue North, Lidgerwood.

ITEMS FOR DISCUSSION

Department of Financial Institutions

Chairman Karsky indicated a document provided by the Conference of State Bank Supervisors was included in the agenda, related to the proposal to allow banks organized as limited liability companies to receive FDIC insurance. Chairman Karsky indicated he did not believe this would be allowed in North Dakota without some legislative changes and that he has discussed this with the North Dakota Bankers Association. He stated he believes any proposed legislation regarding this should be introduced by the banking industry. He explained he understood the reason for allowing banks organized as LLCs to receive deposit insurance is because some of the banks cannot reduce their shareholder levels to that required to comply with the Subchapter S statute, and this would enable them to be taxed equivalent to a Subchapter S corporation.

Chairman Karsky indicated he, Assistant Commissioner Entringer, and Chief Examiner Jungman attended the Directors Training sponsored by the FDIC in Fargo, which he felt was a well attended program. Member Monson indicated he

had also attended and did concur it was a good meeting and opportunity to educate directors. Member Monson noted the FDIC did a good job at keeping it at an executive level without getting into much detail. Chairman Karsky indicated these meetings will be continued throughout the region by the FDIC, and he would like to continue the training in different areas of the state.

Comptroller of the Currency

Alerus Financial National Association, Grand Forks, purchased the assets and liabilities of the BNC National Bank, Fargo Branch located at 3137 32nd Avenue SW, Fargo.

The Board went into closed session at 9:55 a.m.

Timothy J. Karsky, Chairman

Robert J. Entringer, Secretary