

**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**

**July 8, 2010**

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 9:00 a.m., Thursday, July 8, 2010, by conference call.

MEMBERS PRESENT: Timothy J. Karsky, Chairman (*Office*)  
Nancy Baerwald, Member (*Cando*)  
Bill Daniel, Member (*Bismarck*)  
Lorren Henke, Member (*MN*)  
Kim Larson, Member (*Arthur*)  
Roger Monson, Member (*Finley*)  
Anita Quale, Member (*Watford City*)

MEMBERS ABSENT: None

ALSO PRESENT: Robert J. Entringer, Secretary (*Office*)  
Suzette Richardson, Administrative Assistant (*Office*)  
Tim LeClair (*Fargo*)  
Gary Paulson (*Park River*)

**WELCOME NEW BOARD MEMBER KIM LARSON**

Chairman Karsky welcomed Kim Larson to the Board. Member Larson replaces former Board Member Ron Braseth.

## **APPROVAL OF MINUTES**

Chairman Karsky indicated the Board received copies of the minutes of the regular meeting held on May 13, 2010.

**It was moved by Member Quale, seconded by Member Monson, and unanimously carried to approve the minutes as presented.**

## **PROPOSED AMENDMENT TO NORTH DAKOTA ADMINISTRATIVE CODE – SECTION 13-02-09-03 – LEGAL LENDING LIMIT**

Chairman Karsky indicated Assistant Commissioner Entringer has provided three options regarding North Dakota Administrative Code Section 13-02-09-03, mainly dealing with the sale of loans or loan participations. Chairman Karsky indicated due to a GAAP rule that states unless you sell loan participations on a pro rata basis from initiation of the participation they will be counted as borrowings on a bank's books. Chairman Karsky indicated the North Dakota Administrative Code now states if a loan sale does not comply with GAAP it does not constitute as a sale and would be counted towards a bank's lending limit. Chairman Karsky indicated the Department has received calls from bankers questioning this; therefore, it was decided to present options to the Board for consideration of a proposed amendment to the North Dakota Administrative Code.

Assistant Commissioner Entringer indicated at the last meeting the Board instructed the Department to suggest a proposed amendment at this meeting. Assistant Commissioner Entringer indicated he is concerned that if the Board approves an amendment, the bankers clearly understand the impact to risk based capital calculations.

Assistant Commissioner Entringer reviewed his three proposed options: (1) this option indicates an extension of credit must be included except if it is transferred on a last-in first-out (LIFO) basis and the participating interest converts to a pro rata basis on default, then it need not be considered in determining the total direct, indirect, or contingent liability of that borrower; (2) this option removes language and indicates if an extension of credit fails to comply with generally accepted accounting principles (GAAP) and applicable call report instructions then it need not be considered in determining the total direct, indirect, or contingent liability of that

borrower provided the participation or sale agreement converts to a pro rate basis upon default; (3) this option is to delete Subsection 6 of Section 13-02-09-03.

Assistant Commissioner Entringer stated he is concerned there might be unintended consequences with options 2 or 3.

Assistant Commissioner Entringer reviewed his proposed memorandum that would be sent to all banks along with the proposed amendment approved by the Board. Assistant Commissioner Entringer indicated the memorandum details the results of selling loans on a LIFO basis, pro rata on default, and the impact on banks' risk based capital.

Assistant Commissioner Entringer clarified that LIFO loans are not presently prohibited; however, it becomes a lending limit issue, which is the reason for the possible amendment of this Section.

Chairman Karsky indicated the lending limit for state-chartered banks was changed approximately three years ago; therefore, he questions how big of an issue this new GAAP change is.

Chairman Karsky asked Member Henke if he believes this does actually affect the lending limit or other capital issues. Member Henke stated he believes it is more of a capital issue, although he believes one of the proposed options to amend the Section should be approved to protect lending limit issues.

Assistant Commissioner Entringer reiterated that is why he is proposing to send a memorandum to all the state banks explaining if they opt to do a LIFO loan it is clearly understood how it will affect risk based capital.

Chairman Karsky indicated no matter if the Board approves of one the proposed options or not, the Department cannot solve risk based capital issues. Chairman Karsky indicated he is not sure an amendment is necessary; however, is not opposed to starting the rule making process, and if no comments are received supporting the amendment it should be dropped. Chairman Karsky stated the lending limit for banks is very high and few banks have reached the lending limit so they are not affected by this.

Member Monson indicated there are times his bank uses a participation temporarily. Member Monson stated he understands according to FAS 166 if a bank

is at or over its lending limit, there would be a problem under this credit extension. Chairman Karsky agreed this is correct. Assistant Commissioner Entringer and Member Monson agreed under a short-term situation if a larger extension of credit could be done under a LIFO basis this could benefit banks as it would not create a lending problem. Member Henke indicated risk based capital issues would still exist. Assistant Commissioner Entringer added if banks do this on multiple cases by quarter-end the bank could fall below well-capitalized very quickly.

Member Larson stated he believes the risk based capital level is a larger issue than the lending limit.

Chairman Karsky indicated there are two points of issue: (1) a lending limit issue can be solved by amendment this Section of the North Dakota Administrative Code; (2) the State cannot do anything regarding risk based capital levels, as this would come under GAAP.

Assistant Commissioner Entringer indicated the proposed memorandum could be amended to indicate the proposed amendment solves a lending limit issue for a bank; however, does not solve and could create problems under a risk based capital basis.

After further discussion, Assistant Commissioner Entringer explained the process of amending the North Dakota Administrative Code.

**It was moved by Member Monson and seconded by Member Henke to approve Option 1 as the proposed amendment to Section 13-02-09-03 of the North Dakota Administrative Code, along with the proposed Memorandum to state-chartered banks for comment. The motion was unanimously carried.**

## **ORDER AUTHORIZING INVESTMENT IN A LLC**

Assistant Commissioner Entringer indicated at the May 13, 2010, meeting the Board approved an Order be drafted authorizing the investment in a LLC and asking for prior notification. Assistant Commissioner Entringer stated when drafting the proposed Order he discovered this cannot be done, as it would authorize the approval status to the Department and under statute this is designated as an approval status of the State Banking Board.

Assistant Commissioner Entringer indicated the Department has received notification from Bank Forward, Hannaford; United Valley Bank, Cavalier; and The Bank of Tioga the investment in the subsidiary has taken place.

## **CHANGE OF CONTROL APPLICATION – FIRST HOLDING COMPANY OF PARK RIVER, INC.**

Tim LeClair and Gary Paulson joined the conference call at 9:30 a.m.

Chairman Karsky indicated the Department received a change of control application from First Holding Company of Park River, Inc., Park River (Park River HC) to acquire First Sharon Holding Company, Inc., Aneta (Sharon HC) on June 18, 2010. Chairman Karsky indicated joint publication was made according to North Dakota Century Code, and no comments have been received as of this date. Chairman Karsky indicated the Federal Reserve and Federal Deposit Insurance Corporation have also received a copy of the application.

Chairman Karsky indicated Section 6-08-08.1 of the North Dakota Century Code outlines the criteria the State Banking Board must consider when approving or denying a change of control application. Chairman Karsky indicated the Department informed the applicant the application was deemed complete. Chairman Karsky indicated the character, reputation, general fitness, financial standing or responsibility of the persons proposed as new stockholders, directors, or officers, must be considered by the Board and is outlined in the application.

Mr. LeClair stated an application was filed with both the Department of Financial Institutions and the Federal Reserve due to the structure of the application. Mr. LeClair indicated Park River HC is proposing to acquire Sharon HC which owns First State Bank of Sharon. Mr. LeClair referred to Exhibit 3 of the application which indicates the organization structure is Park River HC owning 100% of First United Bank, Park River, and the proposed structure would be for Park River HC to continue to hold 100% of First United Bank as well as 100% of Sharon HC, which in turn would continue to hold 100% of First State Bank of Sharon.

Mr. LeClair stated the reason for this structure, rather than having Sharon HC directly owning the First State Bank of Sharon is that Park River HC and First United Bank are S corporations; Sharon HC and First State Bank of Sharon are C corporations and have some net operating losses as well as some tax credits;

therefore, if the C corporations are merged into the S corporations the tax attributes cannot be utilized. Mr. LeClair indicated the plan is to keep Sharon HC and First State Bank of Sharon as C corporations and utilize the net operating losses and tax credits available to offset against the future profits of that banking organization.

Mr. LeClair indicated Park River HC will form a new holding company known as Sheyenne Bancorp, which will be capitalized with a \$900,000 capital contribution by Park River HC, along with borrowing \$1,925,000 and acquiring the stock from the current owners of Sharon HC, which is approximately 89% by Chuck Youells and 10.84% by Dee Youells. Mr. LeClair continued that Sheyenne Bancorp will be merged with Sharon HC and technically Sharon HC will be the survivor; however, the name Sheyenne Bancorp will be used going forward.

Mr. LeClair indicated the sources and uses of funds, along with purchase price calculations are detailed in the confidential section of the application under Exhibit 1.

Mr. LeClair indicated a portion of the debt to form the new holding company will be carried by the sellers, which is expected to be paid off over a five-year period.

Mr. LeClair indicated pro forma balance sheets as of March 31, 2010, are contained in the public section of the application. Mr. LeClair stated Exhibit 4 reflects the \$900,000 that Park River HC borrowed for the capitalization of Sheyenne Bancorp. Mr. LeClair stated there is a 6% debt in the Sharon HC which is owed to the current shareholders and Board members. Mr. LeClair indicated along with the new borrowings, the debt to equity ratio increases to 14%; however, the final debt to equity ratio would be approximately 31%, which complies with Federal Reserve guidelines. Mr. LeClair indicated the purpose of Exhibit 5 is to show the Federal Reserve that First United Bank has the capacity to pay a dividend for the down payment amount; however, management and the Board have decided to not pull out the excess equity at this point, rather retain the equity and borrow the money and service the debt over a period of time. Mr. LeClair indicated Exhibit 6 reflects the formation of Sheyenne Bancorp and the proposed acquisition transaction and adjustment that would be made to the books to reflect the purchase accounting. Mr. LeClair indicated the end result is that the existing debt of Sharon HC will be paid and the capitalization injected from the Park River HC, with the primary asset the investment in the bank subsidiary of First State Bank of Sharon and the proposed dividend to be paid prior to closing.

Mr. LeClair indicated this is a leveraged transaction as the debt to equity ratio for Sharon HC is approximately 2.5 to 1, and the Federal Reserve guidelines for a small bank holding company stipulate there cannot be a leverage of more than 3 to 1; therefore, these requirements are met.

Mr. LeClair indicated Exhibit 7 reflects the effects of the purchase accounting as of March 31, 2010, on First State Bank of Sharon with the primary adjustment the discount in the loan portfolio, along with a proposed dividend. Mr. LeClair indicated a dividend of \$550,000 was proposed in the application; however, the dividend could be up to \$1 million depending on possible actions taken to maximize the value of the bank.

Chairman Karsky indicated since First United Bank and First State Bank of Sharon will not be merged, First State Bank of Sharon would need approval from the Department for any future dividends. Mr. LeClair agreed and indicated at this time the \$550,000 dividend request has been submitted to the Department. Mr. LeClair explained the reason for the dividend is that Park River HC would like to bring the Tier 1 leverage ratio down to just over 8%, since if there is additional equity it would require additional money be borrowed and injected into the transaction.

Mr. LeClair referred to Exhibit 10 which is the proposed management plan for First State Bank of Sharon. Mr. LeClair indicated the existing directors of First United Bank will be the directors of First State Bank of Sharon, with the addition of Terry Kinneberg, Senior Lending Officer of the First State Bank of Sharon. Mr. LeClair indicated the only change to management is that Gary Paulson will be the President of First State Bank of Sharon. Mr. LeClair indicated Mr. Paulson intends to work at the bank for a minimum of three days and more if necessary to get the bank up and running.

Chairman Karsky asked Mr. LeClair and Mr. Paulson if they have responded to the question by the Federal Reserve on whether Mr. Paulson would initially be working full time if necessary. Mr. Paulson stated he has indicated he will initially work full time if needed, and Mr. LeClair added that response has been sent to the Federal Reserve and copied to the Department. Mr. LeClair indicated during the first five-year period Mr. Paulson will concentrate on finding a future president for the bank.

Mr. Paulson explained only outside directors of First United Bank will comprise the Board of First State Bank of Sharon. Mr. LeClair indicated Mr. Paulson and Mr. Kinneberg would be the two inside directors of First State Bank of Sharon.

Mr. LeClair indicated the intent is to retain all staff of First State Bank of Sharon with the exception of the current president, Richard Anderson.

Chairman Karsky asked if there are any issues concerning the stock of deceased shareholder Dee Youells. Mr. LeClair stated that they are waiting to find out who is the executor of the stock, and added that Chuck Youells has the capability in the Stock Purchase Agreement to sign on behalf of all shareholders. Mr. Paulson added the attorneys for both parties are working on this matter.

Chairman Karsky indicated there is reference in the Stock Purchase Agreement to litigation against one of the current shareholders, and asked whether or not this will impact the First State Bank of Sharon going forward. Mr. LeClair indicated a response is being prepared for the Federal Reserve and will be copied to the Department. Mr. LeClair indicated this is a personal action against Chuck Youells and the Sharon HC is not named in the litigation.

Chairman Karsky indicated the Department has worked with the First State Bank of Sharon very closely the past three to five years and entertained various proposals for change of control, and feels this proposed application will be a good situation for the bank and community. Chairman Karsky stated the Department recommends approval of the change of control application.

**It was moved by Member Baerwald, seconded by Member Larson, and unanimously carried to approve the application by First Holding Company of Park River, Inc., Park River, to acquire the First Sharon Holding Company, Inc, Aneta, and thereby acquire First State Bank of Sharon, dba Sheyenne Financial.**

Chairman Karsky indicated as Commissioner he will approve the \$25,000 dividend request today from First State Bank of Sharon which is to service holding company debt. Chairman Karsky suggested the request for a \$550,000 dividend be acted on by the State Banking Board today. Chairman Karsky added if the amount changes from \$550,000 a letter could be submitted indicating the final amount as

well as the capital level, and he could approve that dividend since it is part of the change of control application.

**It was moved by Member Monson, seconded by Member Quale, and unanimously carried to approve the dividend request of First State Bank of Sharon, Sharon, to pay a dividend of \$550,000 subject to the consummation of the proposed change of control transaction.**

Mr. LeClair and Mr. Paulson left the conference call at 10:02 a.m.

The Board went into closed session at 10:02 a.m.

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Timothy J. Karsky, Chairman

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Robert J. Entringer, Secretary