REGULAR STATE BANKING BOARD MEETING
OFFICE OF THE COMMISSIONER
DEPARTMENT OF FINANCIAL INSTITUTIONS
2000 SCHAFER STREET, SUITE G
BISMARCK, NORTH DAKOTA

May 8, 2003

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, May 8, 2003.

MEMBERS PRESENT:	Timothy J. Karsky, Chairman Ron Braseth, Member Launa Moldenhauer, Member Roger Monson, Member *(Finley)* Gary Petersen, Member
MEMBERS ABSENT:	Bill Daniel, Member Terry Zeltinger, Member
ALSO PRESENT:	Robert J. Entringer, Assistant Commissioner Jeff Jungman, Chief Examiner – Banks Scott Miller, Assistant Attorney General

APPROVAL OF MINUTES

Chairman Karsky indicated the Board received copies of the minutes of the regular meeting held on March 13, 2003. **It was moved by Member Petersen, seconded by Member Braseth, and carried by voice vote to dispense with the reading of the minutes and approve the minutes as published.**

DAN MCLEOD TO ACQUIRE CONTROL OF QUALITY BANKSHARES, INC., FINGAL

Chief Examiner – Banks Jungman reviewed his Memorandum and indicated the application for change of control had been received on April 21, 2003, and was deemed complete on that date. Notice of the proposed change of control was published pursuant to North Dakota Administrative Code Section 13-02-17-01 in the *Valley City Times-Record* on April 23, 2003, with the comment period ending May 5, 2003. Chief Examiner – Banks Jungman indicated no comments have been received nor had there been any requests for copies of the application. Chief Examiner – Banks Jungman pointed out his Memorandum included the approval criteria set forth in Section 6-08-08.1(4) of the North Dakota Century Code. Chief Examiner – Banks Jungman indicated the application states Dan McLeod would be purchasing 10 shares of stock from his father, Ron McLeod, increasing his ownership from 23.58% to 25.58%, or 127.89 shares of the holding company. The purchase price per share as indicated in the application is $2,503.20, or 77.8% of the book value. Attached to the Memorandum is a copy of the December 31, 2002, FRY-9 Statement by Quality Bancshares, Inc. The statement indicates the only asset owned by the holding company is the bank stock which represents $1,608,000. Chief Examiner – Banks Jungman indicates the bank exceeds the State Banking Board's Minimum Capital Policy requirement of 7%, and concluded that there are no major issues involving the bank or its management that would give the State Banking Board cause to deny the application. Chief Examiner – Banks Jungman indicated based on the criteria enumerated in the statute, it is the Department's recommendation to approve the application.

It was moved by Member Monson, seconded by Member Braseth, and carried by a vote of 5 to 0, with Members Daniel and Zeltinger absent, to approve the change of control application by Dan McLeod to acquire control of Quality Bankshares, Inc., Fingal.

APPLICATION TO CLOSE FACILITY LOCATED IN PISEK BY FIRST UNITED BANK, PARK RIVER

Assistant Commissioner Entringer indicated the only information provided to the State Banking Board was a copy of a letter from President Gary W. Paulson to the Regional Director of the FDIC. President Paulson notes in his letter that the facility was opened in 1982, at which time Pisek still operated a K-12 grade school,

which was eventually closed and merged into the Park River school district. President Paulson's letter discusses the decline in population of 26% from the 1990 to 2000 census, and the fact that the bank has shortened the hours of service from six hours per day to one hour per day, three days a week. President Paulson notes the number of transactions per day is approximately nine, and the fact that Pisek is located only eight miles from the main bank in Park River. President Paulson indicates there are only two other businesses in Pisek, and notes that the local grain elevator was consolidated with Park River and another community. The decision to close the facility was influenced by an attempted robbery in December 2002, and included is a copy of a newspaper article noting that the attempted robbery was thwarted. President Paulson indicated the incident made management and the Board of Directors uncomfortable operating a branch with only one employee, given the risks of an armed robbery. President Paulson concluded that the decision is both sound economically and for personal safety reasons.

Assistant Commissioner Entringer noted that attached to President Paulson's letter is a list of facility activity for the last four months of 2002, a copy of the article regarding the potential bank robbery, and a copy of First United Bank's branch closing policy.

Assistant Commissioner Entringer reviewed the requirements of the Board's administrative rule, which is to publish notice of the application to close the facility for two successive weeks in the official newspaper of the county where the facility is located, and the notice must invite comments to be sent to the Board. The Board may not act on the application sooner than 30 days after the date of final publication. Assistant Commissioner Entringer noted no comments had been received and also indicated that President Paulson did not receive any comments regarding the publication. Assistant Commissioner Entringer noted the bank sent out 116 letters to all its customers with a Pisek zip code, and a copy of that letter was included for the Board's reference. The letter restated the information provided to the FDIC and the Department, as to the reason for closing the facility. President Paulson indicated no comments were received as a result of this direct mailing.

Assistant Commissioner Entringer indicated it is the Department's recommendation to approve the application to close the facility in Pisek. **It was moved by Member Braseth, seconded by Member Moldenhauer, and carried by a vote of 5 to 0, with members Daniel and Zeltinger absent, to approve the application by First United Bank, Park River, to close the Pisek facility.**

STATE BANK OF FARGO, FARGO – ARTICLES OF AMENDMENT

Assistant Commissioner Entringer reviewed the proposed Articles of Amendment by State Bank of Fargo. Previously the bank had requested a name change from State Bank of Fargo to State Bank & Trust Company, and this request is to change name from State Bank of Fargo to State Bank & Trust, and also to provide for perpetual existence. The name change and perpetual existence is not to be filed until September 2, 2003, as indicated on the Articles of Amendment, which is the anticipated date for completion of the proposed merger of State Bank of West Fargo and State Bank of Moorhead with and into State Bank of Fargo.

It was moved by Member Moldenhauer, seconded by Member Braseth, and carried by a vote of 5 to 0, with Members Daniel and Zeltinger absent, to approve the Articles of Amendment for State Bank of Fargo to change its name to State Bank & Trust, and also provide for perpetual existence.

ITEMS TO BE NOTED

A. Comptroller of the Currency

The First National Bank of McClusky, McClusky, application to establish a facility at 101 Clark Avenue, Goodrich.

2003 ANNUAL ASSESSMENT POLICY FOR STATE-CHARTERED BANKS AND TRUST COMPANIES

Joan Becker, Director of Administration, joined the meeting at 9:20 a.m.

Chairman Karsky explained each year the State Banking Board has to set its assessments to cover the projected operating expenses for the coming year, and that the assessment must be sufficient to cover those expenses for the banking division only. Chairman Karsky indicated in May 2002 the Department was projecting a carryover of $100,937 for June 30, 2003; however, this year we are projecting a carryover of $143,842 as of June 30, 2003. The reason the carryover is higher than projected last year is there are currently three vacancies, although

one opening has been filled with a transfer from the consumer division and this individual had been with the banking division for approximately 1½ years. Member Braseth inquired whether the positions are posted, and Chairman Karsky indicated within approximately one hour of having the positions posted on the internet the Department started receiving calls, and the response has been very good even though at this point the openings have not been advertised in the newspaper. Member Braseth asked if the positions were opened internally first, and Chairman Karsky answered affirmatively.

Chairman Karsky indicated the Minot Field Office has been closed, but we have not seen any cost savings as of yet. He explained two of those positions will be transferred to Bismarck, and the other will transfer to Grand Forks. Chairman Karsky stated the Department hopes to reopen the Minot Field Office in the future; however, at this time it is easier to fill the vacancies in Bismarck and Grand Forks.

Member Monson asked how many positions are located in each respective field office. Assistant Commissioner Entringer stated currently there are three positions in Grand Forks, four in Fargo, and four in Bismarck, with three vacancies.

Chairman Karsky indicated the Legislature approved the Department budget request for the reclassification dollars, increasing the grades one position, so that the pay grades may be increased for each of the examiner positions and chief examiner. This will make the starting salary more competitive with the current environment.

Chairman Karsky indicated the projected carryover increases to $155,000 at yearend 2004 and it has been the Board's practice to have approximately a 5% carryover of the total appropriation as a cushion. The projected carryover for 2004 represents 12%, but Chairman Karsky stated he did not want to give a credit to the banks until the second year of the biennial, in order to see what effect the reclassification and other cost savings have on the Department's budget.

Chairman Karsky stated prior to the meeting staff was doing "what if scenarios" to see how a 5% or 10% credit would affect the budget numbers. He stated it was conceivable up to a 10% credit would be offered next year.

Chairman Karsky stated the Department can only spend what has been appropriated in our budget bill, so if there are excess revenues, that money will be used to offset the assessments for the following year.

Member Moldenhauer inquired as to whether there was any chance the money would roll into the General Fund, and Chairman Karsky indicated unless the revenue exceeds 20% of the budget appropriations those dollars would not roll into the General Fund.

Member Braseth asked if the Department had to follow state guidelines or its own guidelines as far as cost of living and merit increases. Chairman Karsky indicated the Department has a Salary Administration Plan it follows, but it does not include cost of living increases. Cost of living increases are generally allocated by the Legislature. He stated the Department has the capability to award promotional increases, as well as workload and performance increases; however, must follow Central Personnel guidelines with regard to these types of increases.

Assistant Commissioner Entringer discussed the recommendation made during the Department budget hearing by Representative Carlson, encouraging the Department to look at pay for performance. Department staff indicated that would not be possible currently, but would study the system prior to the next Legislative Session.

Member Petersen indicated he felt it was certainly worth looking at, and Member Moldenhauer agreed, further stating that would certainly help to resolve the problem of losing examiners to banks.

Chairman Karsky indicated the overall assessment schedule will remain the same, although if a bank has grown the assessment will obviously increase.

Chairman Karsky stated the Legislature did not give the Department a great deal of money for operating and equipment expenses for the next biennium. He indicated the salary expense will be higher, which is primarily attributed to reclassifications; operating expenses are down primarily due to the records management program being essentially completed; and the equipment expense is down significantly.

Chairman Karsky indicated the assessment dollar amount is based on the March 31st Call Report numbers and does not factor in the growth between March 31st and June 30th.

Member Petersen asked if Chairman Karsky feels the Department is moving in a positive direction with the criticisms he has been made aware of with the Minot office. Chairman Karsky indicated he feels it is a very positive move; excellent applicants have applied, and he feels very good about the direction the Department is headed.

Chairman Karsky stated he believes the quality of the examinations of the Minot field office area banks will be much better than previously, due to the quality of the Bismarck examination crew.

Member Moldenhauer questioned whether examination staff is spread too thin and Chairman Karsky indicated it should be adequate. He explained two positions were given back in 1997 and that he wishes those positions were still available. He stated the amount of time spent on the road will be watched; however, the examinations should still be efficient.

Chairman Karsky indicated one benefit the field examination staff continues to enjoy is the four-day work week. A discussion regarding travel expenses included meal reimbursement, mileage expenses, hotel reimbursement, etc. Chairman Karsky indicated the meal allowance is barely sufficient to cover costs, but this is governed by State law. The motel reimbursement is also covered by State law; however, it does not seem to be a problem at this time. Mileage reimbursement is not a huge issue, since most of the time the examination staff travel in State Fleet vehicles.

Member Monson inquired as to the $50,000 fee that Bank of North Dakota pays. Chairman Karsky indicated the Bank of North Dakota pays that fee annually and if the examination costs exceed $50,000 every other year that the bank is examined, the Bank of North Dakota would then pay over and above the $50,000. He stated that has not been a problem in the past.

Member Moldenhauer asked about the projected special exam revenue of $3,000. Chairman Karsky explained that would be primarily trust examinations. The projected amount is very conservative and will likely exceed that amount.

It was moved by Member Moldenhauer, seconded by Member Braseth, and carried by a vote of 5 to 0, with Members Daniel and Zeltinger absent, to approve the 2003 Annual Assessment Policy for State-Chartered Banks and Trust Companies.

CAPITAL ADEQUACY AND MAINTENANCE POLICY

Chairman Karsky indicated Chief Examiner – Banks Jungman emailed the proposed changes to the Capital Adequacy and Maintenance Policy to each Board member for their consideration.

Chairman Karsky indicated this is being brought to the Board for discussion because American State Bank & Trust Company of Williston had indicated they felt the Policy was old, outdated, and possibly set too high of a minimum level of capital. When American State Bank & Trust Company of Williston declares dividends, those minimums create a problem; therefore, the bank requested the Policy be amended. Chairman Karsky informed American State Bank & Trust Company of Williston the Policy would be discussed and considered by the Board.

Chairman Karsky indicated Chief Examiner – Banks Jungman ran some numbers and calculated the capital ratios for all the state-chartered banks, and the handout indicated only one bank has a problem with the minimum capital level.

Chairman Karsky indicated if a bank would fall below the minimum, the Department would request the bank submit a Capital Plan on to how capital will be restored to above the minimum level. He stated during the late 1980's and early 1990's, the Department had banks submitting Capital Plans to restore their capital either through earnings retention, injection of capital, or shrinking the assets of the bank.

Member Braseth asked whether most banks have Capital Plans incorporated into their policies, adding that during the routine examination process that is one of the policies both state and FDIC examiners ask for and review. Chairman Karsky stated each bank should have a Capital Policy, but there are still banks that do not have those policies in place.

Chief Examiner – Banks Jungman reviewed the proposed changes to the Policy: (1) State that standard set forth in this Policy will apply to a well managed

and fundamentally sound bank. The reason to insert this is because a definition of well-managed was added. (2) Item 1(a) – cite the correct line item on the Call Report as far as the total asset number. (3) Item 3 – the word "chapter" was removed and the word "policy" was inserted. (4) Item 9 was added to define well managed and fundamentally sound, which means a bank that has a composite one or two and the absences of a rating three or worse in any of the component ratings.

Assistant Commissioner Entringer indicated one of the reasons the American State Bank & Trust Company of Williston is hitting the minimum is because it has had such tremendous growth during the first quarter, and in the request for a dividend the bank indicates it fully expects those funds will leave the bank once rates start to go up again. Chairman Karsky added if a bank expects to grow, it should maintain capital to support that growth.

Member Petersen asked if staff could envision an instance where a bank might be well capitalized under the FDIC guidelines, but not under state guidelines. Assistant Commissioner Entringer indicated he could not because the Tier One Leverage ratio and Primary Capital ratio are very similar in their calculation, where Tier One Leverage does not give you the allowance for loan and lease losses in the calculation whereas Primary Capital does include the allowance.

Chief Examiner – Banks Jungman indicated we could canvas other states as to whether they have their own capital policies in addition to the FDIC, and added he knew Iowa had its own capital policy.

Member Braseth indicated he felt this was a good policy.

Assistant Commissioner Entringer indicated he could recall an instance a merger was approved whereby it would drop the resultant bank's capital below 7%, and the Department requested a Capital Plan before the State Banking Board would consider this, although the Board did approve the merger with the capital at 6½%. The Department did monitor the bank's progress to ensure capital was restored to above 7%.

Chairman Karsky indicated when he discussed the Policy with American State Bank & Trust of Williston he indicated the Policy would be taken before the Board, which is made up of bankers, and that if the Board thought the numbers should be changed, we would certainly look at it. He indicated to the bank that he was comfortable with the numbers.

Chairman Karsky surveyed the Board members and all members indicated they were comfortable with the current Policy; it is easily understood and works well for the majority of the banks in the State.

It was moved by Member Moldenhauer, seconded by Member Monson, and carried by a vote of 5 to 0, with Members Daniel and Zeltinger absent, to approve the amendments to the State Banking Board's Capital Adequacy and Maintenance Policy.

DICUSSION ITEMS

Facility Applications

Chairman Karsky indicated one facility application has been published for a Glen Ullin location, and an application for a facility to be located in Minot should have been received by this time. If the Minot application is received, Chairman Karsky stated a special meeting may have to be held. He stated there are indications another facility application may be submitted for a location in Bismarck.

Removal Action

Chairman Karsky indicated he is about to issue a Complaint and ask for a Stipulation and Consent to the Issuance of an Order to remove an individual who was formerly employed at a state-chartered bank and is accused of making fictitious loans in the amount of approximately $550,000. Chairman Karsky indicated if the individual stipulates, the removal will be in place for three years; however, if the individual is convicted of a crime, the removal will change to a permanent removal. The Stipulation would prohibit the individual from being employed in a bank or credit union, or as a money broker. It appears the individual may currently be employed as a mortgage lender in North Dakota, therefore, the Stipulation includes money broker/mortgage lender.

Industrial Loan Companies

Chairman Karsky indicated he has gotten numerous calls, letters, and emails relative to the Conference of State Bank Supervisors position regarding industrial loan companies. Chairman Karsky stated the concern is that there is proposed legislation which would allow commercial institutions, such as Wal-Mart, to own an industrial loan company and then use the company to branch nationwide. Chairman Karsky indicated he wanted everyone to understand that because North Dakota has approved de novo branching as of August 1, 2003, an industrial loan company could branch into North Dakota after that date. He continued that if the federal legislation would roll back powers for industrial loan companies, the position of CSBS has been that they would not support such legislation to limit the authority of a state to grant powers and that this becomes a state's right issue. Chairman Karsky indicated he is struggling with this issue because he is on the CSBS Board and does know what the banker's position is; however, because of the dual chartering system in the United States, you have seen a lot of expansion of powers because of the states that have authorized powers for state-chartered institutions. Another part of the federal legislation is that it would grant banks the ability to pay interest on business checking accounts which would also grant the industrial loan companies the power to pay interest on business checking accounts. An additional issue is that this federal legislation could force all states to authorize de novo branching and, again, that becomes a state's rights issue – if a state does not want de novo branching, should you be forced into it.

Member Petersen asked Chairman Karsky to keep in mind the big picture because there are a lot of bank-like entities that banks compete with, but yet are not subject to the regulatory scrutiny that banks are subject to.

Sharing Agreement

Chairman Karsky indicated the Department has Sharing Agreements with the States of Arizona, South Dakota, Montana, and Minnesota, and basically we allow the States of Arizona, Montana, and Minnesota to assess fees against the branches located in those states, and then we assess a fee against the branch of a South Dakota bank located in North Dakota. Chairman Karsky indicated the other states really do not do anything to earn those fees because they do not assist us with the examination, but yet we share the fee. The federal legislation mentioned earlier in regard to industrial loan companies also has a provision that states if you do not have an agreement with the home state, you cannot assess a fee against the

branch that you are hosting. Chairman Karsky indicated he had recently signed a Sharing Agreement with Okalahoma that says we will not assess a fee if an Okalahoma bank establishes a branch in North Dakota unless we are asked to assist on the examination, in that case we will be paid a set hourly rate for our examination time. Chairman Karsky stated he is now considering rescinding the Agreements with the other states so that we do not have to share those fees, since those states do not assist in the examinations. This issue will become significantly larger with the pending merger of State Bank of Fargo, State Bank of West Fargo, and State Bank of Moorhead, especially since the Minnesota Department of Commerce has not assisted us with the examinations of the branches in Minnesota. Chairman Karsky stated he will not do anything however to jeopardize losing the state bank to a national charter, if he cannot come to an agreement with the State of Minnesota regarding the cancellation of the Fee Sharing Agreement. Chairman Karsky indicated he feels we are giving up more than we should, and would like to nullify those Sharing Agreements and replace them with an agreement of "we'll pay you when we use you".

FDIC Banker Forum

Chairman Karsky informed the Board that on June 15, 2003, the FDIC will be here to meet with 15-20 bankers from Bismarck and the surrounding area to discuss any items the bankers wish to discuss. The meeting will be held in a conference room located in the Dakota Collectibles Building. Chairman Karsky stated he is not certain which bankers will be attending, and this is something the FDIC plans to do throughout the state in various locations.

The Board went into closed session at 10:35 a.m.

Timothy J. Karsky, Chairman	Robert J. Entringer, Secretary