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

January 11, 2007

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 9:02 a.m., Thursday, January 11, 2007, by conference call.

MEMBERS PRESENT: Timothy J. Karsky, Chairman *(Office)*
Ron Braseth, Member *(Mayville)*
Loren Henke, Member *(Wishek)*
Launa Moldenhauer, Member *(Bismarck)*
Roger Monson, Member *(Finley)*
Anita Quale, Member *(Watford City)*

MEMBER ABSENT: Bill Daniel, Member

ALSO PRESENT: Robert J. Entringer, Secretary *(Office)*
Douglas D. Grenz, Chief Examiner – Banks *(Office)*
Aaron Webb, Assistant Attorney General *(Office)*
Dana Ereth *(Office)*
Bob Fossum *(Minnesota)*
Troy Olson *(North Dakota)*
Dan Rorvig *(McVille)*

APPROVAL OF MINUTES

Chairman Karsky indicated the Board received copies of the minutes of the regular meeting held on November 9, 2006, and the special meeting held on December 15, 2006.

It was moved by Member Braseth, seconded by Member Monson, and carried by a vote of 5 to 0, with Members Daniel and Henke absent, to approve the minutes.

Member Henke joined the conference call at 9:06 a.m.

CHANGE OF CONTROL APPLICATION BY DAN L. RORVIG, TERESA L. RORVIG, ROBERT J. FOSSUM, AND TROY D. OLSON, TO ACQUIRE MCVILLE FINANCIAL SERVICES, INC.

Assistant Commissioner Entringer noted the application had been received on December 18, 2006, and was deemed complete on December 22, 2006. McVille Financial Services, Inc., currently owns 100% of the common stock of McVille State Bank, McVille, North Dakota.

Assistant Commissioner Entringer indicated publication of the notice of change of control was in the *Lakota American*, Lakota, on December 26, 2006, with the comment period ending January 7, 2007. No comments were received nor were there any requests for copies of the application.

Assistant Commissioner Entringer reviewed the approval criteria found in Section 6-08-08.1(4) of the North Dakota Century Code, which was included in his Memorandum.

Mr. Ereth introduced the respective applicants and explained that their biographical information is contained in Confidential Exhibit 5. Mr. Ereth pointed out that the application is an interagency change of control application and stock redemption, noting the application was submitted to the Department as well as the Federal Reserve Bank of Minneapolis. Mr. Ereth indicated the application had been deemed complete by the Commissioner on December 22, 2006, and the Federal Reserve Bank had asked for additional information by letter dated December 27, 2006. Mr. Ereth indicated the information requested by the Federal Reserve Bank was emailed to Assistant Commissioner Entringer on January 9, 2007, which was then forwarded to the State Banking Board members. Assistant Commissioner Entringer asked the Board members if they had received the email with the additional information, and all members indicated they had.

Mr. Ereth indicated the application is basically broken into four sections: the public section of the original application, the confidential section of the original application, the public section of the supplemental information, and the confidential section of the supplemental information. Mr. Ereth referred to page 3 of the original public section of the application which details the four applicants involved in the transaction, noting that Dan and Teresa Rorvig are current shareholders of McVille Financial Services, Inc. Since Teresa Rorvig owns her shares individually she is therefore included in the change of control application. Mr. Ereth directed the Board to page 4 of the application which includes an overview of the current structure, noting that it includes an acquisition of stock as well as a redemption so that at the end of the transaction there will be 150 shares outstanding of McVille Financial Services, Inc., owned by the four respective applicants. Mr. Ereth referred to page 5 of the application which is an overview of the proposed transaction, pointing out that the application is proposed pursuant to Section 6-08-08.1 of the North Dakota Century Code. Mr. Ereth directed the Board to Exhibit 1 which is an overview of the transaction which shows the current ownership and the proposed ownership under the current transaction which indicates after the transaction there will be three parties owning and voting one-third of the stock ownership. Mr. Ereth pointed out that Exhibit 8 is in the original public application, which has been superseded by Exhibit 15 in the supplemental information, which is a more current call report for the bank. The additional Exhibit which was included in the supplemental information in the public portion is Exhibit 11, which is the Affidavit of Publication.

Mr. Ereth referred to the confidential section of the application highlighting items in the Exhibits, reserving comments with specifics regarding numbers or the proposed plan for the closed session of this State Banking Board meeting. Exhibit 2 sets forth the purchase price for the transaction, as well as where the funds will be derived from to accomplish the purchase via holding company debt, as well as private party funds. Mr. Ereth noted that the confidential Exhibit 2 also refers the reader to confidential Exhibit 5, which includes the individual applicants' cash flows, debt service, and sources and uses of funds. Mr. Ereth added that additional information was included in confidential supplemental Exhibits 12, 13, and 14. Mr. Ereth referred to confidential Exhibit 3 which is the resolution and agreement which were drawn up by legal counsel; they are relatively simple compared to what is normally part of a change of control transaction. Mr. Ereth pointed out the resolution indicates everybody is in agreement, buyers and sellers, with regard to the purchase price, adding that the sellers may have been able to get a greater premium but that was not the intention of the current shareholder group.

Mr. Ereth referred to the Consent of Shareholders document and the sentence immediately above the signature line which states that the company and the applicants understand that payment of dividends and other distributions by the holding company is expected to be either prohibited or substantially restricted until the loan for the purchase of the holding company is paid in full. Mr. Ereth noted that payment of dividends from the holding company to the individual shareholders is not included in their individual cash flow projection, and that what is being said is that the bank is going to retain earnings in order to support growth, whatever that growth might be. Also included in confidential Exhibit 3 is a disclosure and consent of prospective shareholders which sets forth the understanding of the prospective shareholders regarding this transaction. Also included under Exhibit 3 is an agreement for the sale and purchase of Darrell Moon's stock which is being purchased by Troy Olson and Robert Fossum, noting that the purchase price is the same as the remainder of the transaction. This seemed to work better from a structure prospective.

Mr. Ereth referred to confidential Exhibit 4 of the original application, which is the pro forma balance sheets, that has been superseded by the supplemental Exhibit 16. Confidential Exhibit 16 is based on the updated Call Report information which was received this week, and Mr. Ereth explained this Exhibit contains a pro forma for both the holding company and bank which specifically identify the transaction and incorporates the impact of pushdown accounting on the bank. Mr. Ereth called the Board's attention to the pro forma for the bank showing the regulatory capital structure, which before the transaction indicates the total risk based capital ratio is 10.42% and after the transaction is 10.17%. Mr. Ereth indicated originally when the application was submitted with the 9-30-06 number, after the transaction the bank was only adequately capitalized; however, the original projections show that by yearend the bank would be well-capitalized after the transaction.

Mr. Ereth referred to Exhibit 5 of the original application which has been supplemented with additional information in Exhibits 12, 13, and 14. This Exhibit is the Interagency Biographical and Financial Reports for the applicants. The additional biographical and financial information in Exhibit 12 is for Teresa Rorvig, Dan Rorvig's spouse, and originally the applicants submitted a joint financial statement, which is included in the original confidential Exhibit 5. Mr. Ereth indicated that additional confidential Exhibits 13 and 14 further detail the individual applicant's financing of the transaction.

Mr. Ereth stated that Exhibit 6 is the loan proposal letter from a correspondent bank noting that originally this transaction was started six months ago and has been heavily involved in the structure of the transaction, in addition to meeting with management and ultimately issued the commitment letter. Mr. Ereth pointed out that the commitment letter talks about assuming some existing debt of the holding company, noting that the projections show the assumed debt is being paid off in 2007. However, the terms of the assumed debt involves some flexibility for the applicants because the note is not actually due until 2011. Mr. Ereth reiterated that although the debt is shown as being paid off in 2007, it is not actually due until 2011; therefore, if the bank experiences growth and needs to retain earnings the holding company does have some flexibility.

Mr. Ereth explained that confidential Exhibit 7 has been superseded by supplemental confidential Exhibit 17, which are the projections of the bank and holding company. Again, the projections have been updated with more current information from the December 2006 Call Report.

Mr. Ereth referred the Board to confidential Exhibit 17 which includes detailed projected financial information for both the holding company and the bank, adding that they have been working fairly close with the correspondent lender and have done a very detailed profit and loss projection with the lender for a 10-year period, adding that this projection filtered down to this overview. Mr. Ereth stated that included with confidential Exhibit 17 is a pro forma balance sheet for the holding company which shows what the actual balance sheet looks like, as well as what it would look like assuming the transaction were complete on 12-31-06. Mr. Ereth pointed out the stockholder equity section shows the 150 shares outstanding times the purchase price plus an income tax benefit. Mr. Ereth stated the debt to equity ratio is highlighted on this page, noting that one of the Federal Reserve Board criteria for approval would be the reasonableness of the leverage at the holding company, and added that in essence the applicant has met all of the Federal Reserve requirements as structured.

Mr. Ereth referred to the holding company's income statement and cash flow, pointing out that they are not projecting any dividends to stockholders.

Member Henke asked Mr. Ereth if the company would be a Sub S Corporation, and Mr. Ereth indicated it would be. Member Henke asked if there would be any dividends from the holding company to the shareholders to pay the tax liability and Mr. Ereth indicated there would not. Member Henke stated the

individual shareholders would then be responsible for the taxes on their share of the income from the bank, and Mr. Ereth indicated that was correct. However, the perspective that the holding company has debt from which the interest is deductible as well as the debt that the individual shareholders have incurred which is also deductible, they are projecting their personal tax liability for at least the first five to six years to be $5,000-$10,000, at which point the holding company should be less than one to one debt to equity which would enable them to pay dividends if they wanted to. Mr. Ereth further pointed out when looking at the cash flows for the individuals those do reflect the tax liability for the individual shareholders from the holding company income.

Mr. Ereth referred to the debt schedule, pointing out there is some flexibility in that the first five years of debt is only requiring interest payments, adding that the bank stock lender is quite comfortable with how the debt is structured.

Chairman Karsky asked if the interest rate on the debt was fixed and Mr. Ereth stated it is prime minus a quarter of a point and is adjustable; however, they did not get into trying to project interest rates over the 10-year projection period.

Mr. Ereth referred to several pages that are the assumptions that went into building the projections, pointing out that note #1 is just the nature of the projection and the individual applicants, note #2 is a description of the proposed transaction and obviously the transaction will not be accomplished by December 31, 2006, but as soon as practicable after approval. Mr. Ereth stated note #4 indicates the debt with the proposed transaction; note #5 states it is a Sub Chapter S company; note #6 again states that the company does not project any dividends going to shareholders and that the applicants are committed to maintaining the bank in a well-capitalized category and the projections will show that the bank will remain in a well-capitalized status throughout the period of the projection.

Mr. Ereth referred to the funding growth in note #7b which includes table 1 detailing the core deposits of the bank. Mr. Ereth pointed out that core deposits have grown over 8% annually since 2000, adding that 8% core deposit growth in an independent community rural bank in North Dakota is strong. However, when looking back, the years 2002, 2004, and 2006 show double-digit increase in deposit growth which is a reflection of the bank's recent branching activity. Mr. Ereth indicated the bank opened a facility in Binford in 2002, a facility in Sykeston in 2004, and a facility in Northwood in 2006. Mr. Ereth continued that no one involved with the transaction thinks that an 8% annual growth rate is achievable

over the next 15 years. Mr. Ereth stated the Federal Reserve Bank requires the applicants to use historical funding growth rates in the projections; therefore, for capital planning purposes an 8% funding growth rate is used.

Mr. Ereth stated Table 2 on page 3 of the notes in Confidential Exhibit 17 shows the actual 2006 deposit growth and in the original application deposits were projected to come in at approximately $22 million; however, the updated figures show it came in just over $24 million. This Table details where that growth came from.

Mr. Ereth stated that page 4c is the historical loan growth which again appears to be a reflection on the branching activity because there is close to a 12½% annual growth rate in loans since 2000. Mr. Ereth stated for projection purposes the applicants used 8% loan growth for the simple reason that they used 8% funding growth and the applicant is not going to be taking on borrowings to fund loan growth; therefore, you can see how these two work in tandem. Mr. Ereth stated if the loan growth and the funding growth are there it is only constrained by capital; however, if the loan growth is not there they would not expect the funding growth to be necessary and therefore your capital ratios will probably be understated in the projections.

Mr. Ereth stated page 5 gives a historical look at the pretax net operating income and since this is a Subchapter S bank, he prefers to use pretax net operating income for projection purposes so compared to peer you can see where the bank is at. Mr. Ereth stated fluctuations can be noted on the return on average assets which is a combination of the expenses associated with opening the branches and the growth. Specifically you can see a drop in return on average assets in 2001 when the Binford facility was opened; in 2004 when the Sykeston facility was opened; and again in 2006 when the Northwood facility was opened. Mr. Ereth stated if you remove the expenses associated with these facilities and did an average, it would be closer to 1.75% return on average assets; however, given that these are the averages over the last five years (1.4%), 1.3% was used in the projections. Mr. Ereth continued that the 1.3% does not take into account the amortization of a premium and so the projections will be lower than what the applicants realistically feel they could be.

Mr. Ereth stated on page 6 it shows the applicants tend to run the bank as a well capitalized institution; and the final page details the actual bank projections. Mr. Ereth stated the asset growth rate is approximately 8% based on the funding

growth, with a pretax return on average assets of 1.3% before amortization of the premium which is reflected in the stockholders equity section. Mr. Ereth stated as shown in the total risk based capital ratios they stay above 10%, noting they bottomed out at 10.01% in 2007, and again, this is based on an 8% growth rate and totally repaying the debt that is not due until 2011.

Chairman Karsky asked Mr. Ereth to review what will happen regarding management and the Board if this application is approved. Mr. Ereth indicated that information can be found in Exhibits 9 and 10 of the original application; specifically, Dan Rorvig would assume the role of Chairman of the Board and Chief Executive Officer; Darrell Moon, who is the current Chairman of the Board and Chief Executive Officer has agreed to stay on as President, but more realistically as a consultant/support person for Dan Rorvig; Troy Olson would be a Director; and Robert Fossum would be a Director and Vice President, with his background in lending. Mr. Ereth indicated Exhibit 10 includes a proposed business plan which was put together by Dan Rorvig, Troy Olson, and Robert Fossum. Mr. Ereth added he is aware the Federal Reserve Bank expressed concerns as to the condition of the bank; therefore, the applicants put together this business plan showing they believe any previous examination concerns will not be an issue in the future.

Chairman Karsky asked Mr. Fossum who would be running the bank on a day-to-day basis, as far as lending and management. Mr. Rorvig indicated Darrell Moon has agreed to stay on for at least one year and will continue to be responsible for the investments. Mr. Rorvig indicated they believe Mr. Fossum will contribute his expertise in lending to increase and improve the format for loan reviews. Mr. Rorvig indicated he is a native of McVille, and began at the bank in 1990 with lending responsibility. Mr. Rorvig indicated Troy Olson will be at the bank on a day-to-day basis when Mr. Moon retires.

Chairman Karsky stated the application indicated Mr. Fossum will also act as a consultant and asked when he would find time to do that. Mr. Fossum indicated they have discussed this and indicated there is flexibility to do workouts and guarantee work for other institutions. Mr. Fossum stated he began a business out of his home in 1997 offering workout and guarantee services and found much of that can be done on non-traditional work hours. Mr. Fossum indicated he has been in contact with some lending institutions and feels this can be accomplished evenings and weekends. Chairman Karsky asked Mr. Fossum if those institutions are aware he will be a shareholder in McVille State Bank; Mr. Fossum indicated

yes, and added he currently has been employed with Alerus as a special credit officer and has notified them his possible affiliation with McVille State Bank. Mr. Fossum stated Alerus has indicated upon approval of this application, they would enter into a contract with him for continued workout services. Mr. Fossum stated he feels that is a strong vote of confidence on the part of Alerus, as they understand the work will get done. Mr. Fossum indicated he has been approached by another bank for services, and after explaining what his responsibilities may be to McVille State Bank the bank indicated they accept that and would still like to set up a contract with him.

Member Moldenhauer asked Mr. Fossum if he will continue living in Forest River and where Forrest River is located in relation to McVille. Mr. Fossum indicated Forest River is 30 miles north of Grand Forks, which is approximately 40 miles from Northwood and 65 miles from McVille. Mr. Fossum indicated it is his intent to continue to live in Forest River; currently he commutes to Grand Forks, but not on a daily basis. Mr. Fossum continued he is used to being on the road due to the Alerus offices in Fargo and Northwood.

Member Monson asked Mr. Rorvig for a point of clarification as to Darrell Moon's situation, noting it has been indicated Mr. Moon will remain as a consultant working mostly with investments, and wondered if that was an open-ended contract. Mr. Rorvig indicated the arrangement with Mr. Moon will continue to yearend 2007 and possibly through August 2008. Member Monson asked if Darrell Moon would continue working with Mr. Rorvig in the CEO capacity and handle investments, and if the lending would be handled by Mr. Rorvig and Mr. Fossum; Mr. Rorvig indicated that is correct.

Member Monson asked if Mr. Ereth has accounted for either additional consultant or salary fees in the projections. Mr. Ereth explained the salary for Mr. Fossum has been accounted for through a reduction of Mr. Moon's salary, and added the retirement of another shareholder who is also an executive officer at the bank presently was also accounted for. Mr. Rorvig added the end result is approximately a $2,000-$3,000 increase in salaries.

Chairman Karsky indicated previous examinations have noted lending issues in the bank, adding he is concerned the bank is going to need a fulltime lending employee. Chairman Karsky stated he believes Mr. Fossum should assume that role, but questions the amount of time Mr. Fossum will not be in the bank. Chairman Karsky indicated he is not aware of the bank's loan portfolio condition

presently, but that issues were identified at the last examination and he still has concerns regarding those issues. Mr. Fossum indicated he fully understands that initially he will need to spend a great deal of time at the bank to get the credit administration policies set up and start going through files. Mr. Fossum continued that McVille State Bank will be his first priority, and making the extra effort to get the work done does not concern him as he has been doing similar work the past 10 years.

Chairman Karsky indicated he believes Mr. Fossum will need to be at the bank on a fulltime basis even after the policies are set up; adding his salary, job responsibilities, and arrangement with the bank will be looked at during a future examination. Mr. Fossum indicated he does not argue that point, and if the question is whether he will be a two-day or three-day-a-week employee, his intention is he will be at the bank five days a week as a fulltime employee, and any contract work will be part-time commitments.

Chairman Karsky asked Mr. Rorvig if he could provide an update to the Board on the condition of the bank's loan portfolio in this public section of the meeting. Mr. Rorvig stated some of the concerns that were justified are in the area of participations purchased, and as indicated in the business plan that practice will be eliminated. Mr. Rorvig stated since the June 30, 2006, examination classified participations have been reduced through pay downs by more than half, which shows progress has already been made.

Member Monson referred to the projection wherein it is indicated deposit growth for the next 12 years, using 8%, is historical growth. Mr. Ereth indicated the applicant does not anticipate 8% loan or deposit growth, adding that the projections do not make any change to net income; obviously if they even approach 8% loan growth the bank would be more profitable. Mr. Ereth stated the Federal Reserve Bank requested projections based on historical growth rates.

Mr. Ereth directed the Board's attention to Exhibit 10 of the original application which includes the bank's business plan; within that business plan is Attachment A which defines why this transaction works and is deserving of the Board's approval. Mr. Ereth continued the Mcville State Bank is an independent state-chartered bank and the applicants are looking to transition it to a new group of shareholders. He pointed out the application is structured to meet all the Federal Reserve criteria, and the decision criteria under the North Dakota Century Code, adding that he believes the business plan as well as the entire application shows that no one will be jeopardized by approval of this application. Mr. Ereth added

that Attachment A shows that the applicants have met the additional requirements of the Federal Reserve.

Member Moldenhauer asked if there is a recommendation from the Department regarding this application. Chairman Karsky indicated a recommendation was not included, as this is a highly leveraged application and is the reason Mr. Ereth was requested to review the transaction is greater detail. Chairman Karsky indicated he certainly has some issues with the application; adding that he feels there is not a lot of strength in the holding company if additional capital is needed, which places more importance on accuracy of the projections regarding loan and funding growth. Chairman Karsky indicated the applicant has some options on the remaining holding company debt since it is not due until 2011, and that the Department would definitely examine this bank within the next 12-15 months.

Member Moldenhauer questioned if the bank would be the taken care of since it appears a considerable amount of time would be spent with other entities. Chairman Karsky stated there has to be a commitment from the applicants that the bank is the first priority. Chairman Karsky continued there is a concern if the applicants will be relying on cash flow from outside businesses to pay taxes.

Member Henke stated he has found over the years that it is very difficult to have businesses on the side while running a bank.

This conference call had been scheduled for one hour and therefore adjourned at 9:58 a.m. The Board agreed to reconvene January 12, 2007, at 9:00 a.m. via conference call.

JANUARY 12, 2007

The Board reconvened on January 12, 2007, at 9:02 a.m. by conference call, with the same members in attendance as on January 11, 2007, with the addition of Darrell Moon, McVille.

Chairman Karsky indicated at the conclusion of the meeting yesterday the Board was still considering the application for change of control of McVille Financial Services, Inc., McVille.

Chairman Karsky informed the Board that he and Assistant Commissioner Entringer met with Mr. Ereth, Mr. Rorvig, and Mr. Olson prior to this meeting, adding that he now has a more favorable comfort level regarding the application. Chairman Karsky indicated the projections were discussed, adding that the projections that were received were the ones the Federal Reserve Bank requested be redone using the 8% growth rate. Chairman Karsky had informed the applicants he feels it would be beneficial if they provided the realistic projections, and Mr. Ereth indicated in the original application under Confidential Exhibit 7, those projections were done using a 5% growth rate which is more realistic.

Mr. Ereth apologized that the updated projections were submitted only one day in advance of the meeting, but that the applicants were waiting for the bank's yearend Call Report. Mr. Ereth pointed out that in conversations with the Federal Reserve Bank there is a small bank holding company statement that allows the transition of small banks using leverage factors higher than traditional leverage factors for banks, but in order to do that the commitment to remain well-capitalized is very pertinent; therefore, the applicants wanted to wait for the yearend Call Report to show exactly what the effect was going to be in the first quarter if this transaction is consummated. Mr. Ereth stated as discussed yesterday the Federal Reserve Bank prefers to take a historical perspective on projections rather than trying to deal with the assumptions; therefore, they look at a five-year history. Mr. Ereth stated the growth factor was the largest issue on the bank's capital levels, noting that the revised projections went from a 5% funding growth to an 8% funding growth just because the yearend deposits were up from what was projected in June. Mr. Ereth indicated he chose to run a sensitivity analysis in this application, assuming they do not realistically project an 8% growth, but what would capital levels look like if they did use an 8% growth rate. Therefore, the additional Confidential Exhibit 17 shows that the bank would remain well-capitalized using an 8% funding growth rate. Mr. Ereth pointed out that the

applicants have been committed from the beginning of this application process to remain well-capitalized; therefore, no matter what the growth factor is, the commitment of the applicants remains the same.

Chairman Karsky indicated in using the 8% projections the bank does remain well-capitalized, and Mr. Ereth indicated the applicants focus on the total risk-based capital ratio since that is the one most banks have difficulty maintaining because the growth is generally in loans which is 100% risk-weighted. Therefore, when you look at the revised projections using an 8% growth rate, it shows the applicant bank does get down to 10.01% on a total risk-based capital ratio. Mr. Ereth pointed out that the business plan included in the application shows they are probably understating the risk-based capital ratio because of the expertise that Robert Fossum brings is in guarantees and currently the bank does not use federal guarantees on its loans. Mr. Ereth continued that there are some loans in the portfolio that could utilize a government guarantee and reduce the risk weighting for those assets, which would actually improve the bank's risk-based capital ratio. Mr. Ereth indicated that Exhibit 7, which are the original projections are probably more realistic as to what the applicants believe they will achieve because if you look at the 8% projections that was taking into account the impact of the three facilities which were opened, and these applicants have no intention for additional facilities.

Chairman Karsky stated if you look at the projections in Exhibit 7 the capital ratios are actually higher than the amended projections, and Mr. Ereth indicated that is correct.

Chairman Karsky pointed out that in the original Exhibit 7 the total risk-based capital ratio was 11.4% versus the revised projections of 10.17%, which is a significant difference. Chairman Karsky continued if the Board thought the 8% growth rate was optimistic and use a more realistic funding growth of 5%, the capital ratios actually turn out to be better.

Chairman Karsky asked Mr. Ereth if he could explain how the earnings and the spread actually remain the same and has a positive effect on the earnings. Mr. Ereth indicated that was correct, that they used a pretax ROA of 1.3% in the projections, adding that if you take out the years that there were startup expenses related to the openings of the facilities the bank has actually averaged approximately 1.75% as a return on assets. Mr. Ereth continued that when you use the 5-year average it actually comes in at 1.4%, and they chose to be conservative

at 1.3% for net income. Mr. Ereth stated in talking with Darrell Moon and Dan Rorvig yesterday, the revised projections show pretax net income of approximately $370,000, and if Mr. Moon and Mr. Rorvig were doing their budget now that is what they would be projecting for pretax net income. Mr. Ereth continued the other part of this is that if the bank is doing 8% growth and has the negative impact on risk-based capital that is being talked about, the positive impact will be on earnings, because the funding growth is only going to be necessary if there is loan growth; therefore, a 1.3% pretax ROA, with all else being equal, we have the people involved already so additional salary expense will not be taken out, so the pretax ROA should be higher than what is being projected. Mr. Ereth indicated the applicants wanted to present this as a possible "worst case scenario" to see what the projections would show as far as what they could service. Mr. Ereth indicated the applicants are very comfortable with what this bank has done historically and that the projections will be at least indicative of what the bank can do, adding that when Eide Bailly gets involved they use the projections as a strategic planning tool. Mr. Ereth stated he is confident what is being proposed will be met based on his meetings with the applicants, knowing what their philosophy is and what their plan is going forward.

Assistant Commissioner Entringer added that in his Memorandum he does indicate that the financial projections for the bank and holding company appear to be reasonable and consistent with historical information, adding that he did look at the projections and compared those to the Uniform Bank Performance Report and found them to be consistent with what the bank has done historically over the last five years.

Chairman Karsky indicated he felt the meeting this morning was very beneficial, and further that he feels it is imperative we review again who will be in the bank and what position each individual will hold if the change of control application is approved.

Mr. Ereth indicated Dan Rorvig will be Chairman and Chief Executive Officer, and will be assisted in the transition by the current Chairman and Chief Executive Officer Darrell Moon. Mr. Ereth indicated the current stockholders want the transition of McVille State Bank and how it served the community to be continued, adding that Mr. Rorvig is a lifetime resident of McVille.

Chairman Karsky asked Mr. Rorvig to explain what his role has been in the bank and what it will be in the future. Mr. Rorvig indicated he is a native of McVille; however, did spend five years banking in Kidder County after college.

Mr. Rorvig indicated on a day-to-day basis he will be the Chairman of the Board, will be in the bank every day, and that Mr. Moon, who has been with the bank since the 1970s, will continue at the bank to help with the transition on a consultant basis as well as managing the investments. Mr. Rorvig indicated Mr. Moon has been handling the commercial participations but the intention is to let those run off, and that Mr. Moon's intention is to be at the bank at least through 2007 and possibly until August 2008. Mr. Rorvig indicated he has been at the McVille State Bank since 1990 and has probably done 90% of the local lending over the last few years; when looking at that aspect of the portfolio, lending has been sound. Mr. Rorvig indicated he worked through the change in ownership that occurred in 1992, and in 1999 he and Teresa Rorvig bought their shares of stock. Mr. Rorvig stated it is his intention to continue to work as he has been for the last several years. Mr. Rorvig continued that it is his and Mr. Olson's intention to bring Mr. Olson into the bank as time permits. Mr. Olson currently works for Nodak Electric. Mr. Rorvig indicated that Robert Fossum worked for Farm Credit Services and for SBA; he has done some consulting work and guarantee work, adding that he has managed a large portfolio of guaranteed loans. Mr. Rorvig continued that although Mr. Fossum does live in Forest River and will remain living there, he will be present in the Northwood facility every day. Mr. Rorvig indicated they intend to take advantage of Mr. Fossum's abilities, specifically with guaranteed loans, adding that they have identified $3-$4 million in loans which could be potentially guaranteed, adding that these loans are not criticized, but they would look at improving the bank's position and reducing any risk potential out there.

Chairman Karsky indicated he was confused yesterday as to who the primary lender would be, adding that Mr. Rorvig has been the primary ag lender and if it is the bank's intention that ag lending continue to be the bank's focus, he could state that the bank's problems have not been in the ag lending portfolio.

The Board went into closed session at 9:21 a.m., and reconvened into open session at 9:27 a.m.

Mr. Fossum indicated he wanted to clarify as to what his role and responsibilities are with regard to this transaction. Mr. Fossum stated his intent is to be based in Northwood; however, he will be at whatever facility needs attention. Mr. Fossum continued that more of an overall credit administration function is the intent and what has been discussed is to begin a comprehensive loan review for all loans over $150,000, and through that process get proper risk ratings and

guarantees if necessary and get all necessary procedures in place to monitor the guarantees. Mr. Fossum indicated first and foremost his efforts will be to conduct the loan review program, adding that any outside contract work he conducts will take second place. Mr. Fossum stated since he will be in an ownership position and an officer of the bank, McVille State Bank will be his priority. Mr. Fossum continued the first priority will be to enact the policies that are set forth in the business plan, which include loan review function and problem review action plans. Mr. Fossum indicated in regard to the government guarantee programs, he enjoys working with them and knows them very well; however, he is aware that both FSA and SBA are hungry for business, and a guarantee for a farm is an easy sell especially if the individual is struggling and there is interest assistance, adding that the FSA offices that serve in locations where McVille State Bank has facilities all want business so the opportunity is very good and the intent is to get these guarantees in place this spring. Mr. Fossum stated if they took $3 million of existing credits and got 90% guarantees, it is easy to see what will happen to the risk-based capital ratios. Mr. Rorvig added that they intend to take advantage of Mr. Fossum's expertise in the guarantees, adding that Mr. Rorvig will continue to be the senior lender for the bank.

Chairman Karsky indicated Mr. Olson is present and asked if he would like to add anything at this time. Mr. Olson stated he was raised in the Velva area but has lived in the Finley/Cooperstown area for the past 20 years, and has worked at Sheyenne Valley Electric in Finley until they merged with Nodak Electric. Mr. Olson indicated he knows the people in the area and surrounding communities very well, adding that when he started with Sheyenne Valley Electric he was in marketing and covered Nelson, Steele, and Griggs County. Mr. Olson stated since working for Nodak Electric he has been able to meet more people in the Grand Forks County area. Mr. Olson indicated his background is in engineering, but he intends to eventually learn the lending area by working with Mr. Rorvig.

Member Henke summarized the transition, indicating that Mr. Rorvig would continue as the senior lender and take care of the loan portfolio; that Mr. Moon would stay on as a consultant and taking care of investments over the next 1½ years; however, wondered what the transition would be after Mr. Moon leaves. Mr. Rorvig indicated he would assume those responsibilities and the intention is that Mr. Olson would become part of the operation and eventually assume many of the duties that Mr. Rorvig is currently responsible for. Mr. Rorvig added that Mr. Fossum would continue to do more lending also.

Member Henke stated people tend to think banking is primarily lending and taking deposits; however, lately a lot of time is spent on compliance issues, information technology, and policies. Member Henke added he is sure Mr. Moon is handling most of that, which is not a part-time job. Mr. Rorvig indicated they do realize that and those items are getting done now and will continue to get done. Mr. Rorvig indicated the current compliance officer has been with the bank for quite some time and will remain with the bank. Mr. Rorvig added this individual is also the bank's secrecy act officer.

Member Braseth asked if the Department had a recommendation after meeting with the applicants and consultant this morning. Chairman Karsky indicated he feels much better regarding the application and that Assistant Commissioner Entringer will offer a recommendation.

Mr. Ereth informed the Board that since yesterday's meeting he had more time to think about the application, and would therefore present his final conclusions. Mr. Ereth indicated he would focus on the decision criteria under Section 6-08-08.1(4) of the North Dakota Century Code.

Mr. Ereth referred to the first criteria regarding publication, noting that there were no requests for copies of the application and there were no comments, which indicates to him that the area bankers do not have any issues with the application.

Mr. Ereth referred to Section 6-08-08.1(4)(a), regarding the character, reputation, general fitness, financial standing of the applicants and the officers, which in this situation are the same, in terms of whether they would jeopardize the creditors, depositors, and stockholders. Mr. Ereth stated in terms of creditors this transaction is highly leveraged; however, the applicants have had no less than seven outside bankers look at this transaction and they have given this transaction their approval and support. Mr. Ereth indicated when he works with individuals the first thing he looks at is what bankers think of the transaction, and holding company lenders to the individual stockholder lenders haven given their approval by issuing a commitment to lend the money. Mr. Ereth stated Eide Bailly puts its reputation on the line by believing the depositors will not be jeopardized. Mr. Ereth stated that initially Eide Bailly was not comfortable with this transaction, but after working with the applicants they feel this will work. Mr. Ereth stated the applicants are the stockholders in this situation so there will be no other stockholders jeopardized. Mr. Ereth stated the existing stockholders want to see the transition of this bank to the new ownership group to ensure the same

commitment to the McVille community as the current ownership group. Mr. Ereth stated the ownership in the proposed transaction is divided equally by thirds, so that it is equal money and an equal commitment. Mr. Ereth pointed out that there have been some issues raised during the meeting as to the commitment of some of the individuals, and explained that Mr. Rorvig is the key to the transaction, Mr. Fossum brings his lending expertise as well as investing his life savings into the transaction, and Mr. Olson brings a familiarity with the public due to his long time experience with a local public cooperative. Specifically, Mr. Ereth referred to the Federal Reserve Board's Regulation Y with regard to the stockholders in a small bank holding company which essentially allows higher debt levels for the formation of smaller bank holding companies than would ordinarily be permitted for a larger bank holding company. Mr. Ereth stated this is exactly what the transaction is, a higher leverage transaction of an independently owned state-chartered bank. Mr. Ereth indicated the alternative would be for the stockholders to put the bank on the market and in order to retain an individual charter it will take leverage because there probably are not a lot of investors that would come forward with the funds to acquire this bank if they are not already bankers who want to leverage their existing financial institution.

Mr. Ereth referred to Section 6-08-08.1(4)(b), North Dakota Century Code, which deals with management. Mr. Ereth indicated the existing management is already in place, as Mr. Rorvig has been working at the bank since 1990, and Mr. Moon has committed to stay on until the end of 2007 or possibly August 2008.

Mr. Ereth stated the bank has been run as a sound bank, although there were some issues related to out-of-state bank participations, which is why management chose to establish the existing facilities as a means of growth. Mr. Ereth indicated when looking back at net credit losses for this bank in 2005 it was 0; 2004 it was $34,000; 2003 it was $2,000; and 2002 it was $25,000 in losses. Mr. Ereth stated over the last five years management has charged off $60,000 in local loans, and that is the experience they offer. Mr. Ereth acknowledged that the credit issues will be an issue for the Federal Reserve Bank, but as discussed in the closed session, those issues are in the past, adding there has been a decrease in classified loans which the next examination should show, the out-of-state participations have been stopped and if the facilities work as planned there should be no need for out-of-state participations. Mr. Ereth stated the budgeted net income is in line with the projections and should be short of what they actually expect to earn; earnings and growth are expected to stabilize and we have discussed that we do not expect the bank to grow at the rate in the projections provided to the Federal Reserve. Mr.

Ereth indicated this is the ultimate in succession plans as the existing stockholders negotiated a straightforward deal with the applicants and existing management will not be leaving when the transaction is consummated. Mr. Ereth stated the proposed management and their experience were previously discussed and the Exhibits in the application set forth financial backgrounds. Mr. Ereth stated the management plan sets forth the intentions regarding this transaction.

Mr. Ereth referred to the business plan, which he feels raised confusion regarding Mr. Fossum's role in this transaction, along with the current credit administration issues. Mr. Ereth referred to Attachment A in Exhibit 10, noting that the criteria in the statute really comes down to management. Mr. Ereth stated the applicants meet the criteria; it is less than 3 to 1 leverage which is the maximum the Federal Reserve will consider. Mr. Ereth stated the applicants acknowledge the leverage is high in this transaction, but that it is a workable plan. Mr. Ereth indicated the applicants project to meet all the debt servicing requirements with realistic assumptions, which will likely be exceeded; there are bank stock lenders committed to this transaction with flexibility in repayment; the transaction is projected to remain well-capitalized even at an 8% funding growth, as well as the commitment on the part of the ownership group to maintain the well-capitalized status. Mr. Ereth pointed out as shown in Attachment A that the bank holding company is projected to be well under the .3 to 1 debt to equity within the 12 years and debt free within 15 years. Mr. Ereth stated that no holding company dividends are projected, although they can pay dividends once the debt to equity falls below 1 to 1, and the projections show that will happen within five years.

Mr. Ereth indicated the final result is this is a transition from the existing stockholders that has been agreed to and a new ownership group with a commitment to the community.

Mr. Ereth indicated he is asking for the State Banking Board's approval of this transaction, but also their support because the Federal Reserve Bank has indicated this transaction will be deferred to the Board of Governors, and the applicants will need the State Banking Board's support as far as the management of this institution.

Assistant Commissioner Entringer indicated based on the criteria which are set forth on page 2 of the Memorandum, it would be the Department's recommendation to approve the application as presented.

It was moved by Member Monson and seconded by Member Braseth to approve the change of control application by Dan L. Rorvig, Teresa L. Rorvig, Robert J. Fossum, and Troy D. Olson to acquire McVille Financial Services, Inc., as presented.

Member Monson asked whether the Board's approval is subject to the approval by the Federal Reserve Bank, and Chairman Karsky indicated the Board does not issue an Order regarding a change of control application; however, if the Federal Reserve Bank does not approve the transaction, it cannot go forward.

Member Henke asked how soon the transaction would be consummated, assuming Federal Reserve Bank approval is granted, and Mr. Ereth indicated they are expecting Federal Reserve Bank approval by mid-February 2007.

The motion was carried by a vote of 6 to 0, with Member Daniel absent.

The Board recessed at 9:59 a.m., and reconvened at 10:07 a.m.

ADDITIONS TO THE AGENDA

Assistant Commissioner Entringer reviewed the Articles of Amendment for United Community Bank of North Dakota, Leeds, and Quality Bank, Fingal, to extend their corporate existence to perpetual existence.

It was moved by Member Moldenhauer, seconded by Member Henke, and carried by a vote of 6 to 0, with Member Daniel absent, to approve the Articles of Amendment providing for perpetual existence for United Community Bank of North Dakota, Leeds, and Quality Bank, Fingal.

ITEMS TO BE NOTED

Department of Financial Institutions

Articles of Amendment

Garrison State Bank and Trust, Garrison, to change number of directors from no less than 5 and no more than 11, to no less than 4 and no more than 8.

Comptroller of the Currency

Effective 9-25-06, Bremer Bank, National Association, Fargo, opened branch at 1204 19th Avenue North, Fargo.

Received 11-1-06 and Approved 12-7-06, Alerus Interim, National Association, 10900 Wayzata Boulevard, Minnetonka, MN, and Stanton Trust Company, National Association, 3405 Annapolis Lane North, Suite 100, Plymouth, MN, to merge into Alerus Financial, National Association, Grand Forks, ND.

Effective 12-1-06, First Security Bank, Underwood, merged into The First National Bank of McClusky, McClusky.

LEGISLATION

Chairman Karsky noted the Department had its budget hearing before the House Government Operations Subcommittee of the Appropriations Committee. Chairman Karsky indicated the hearing went fairly well, although we do have to provide some additional information to the Committee.

Chairman Karsky noted the banking bill which raises the Board members' per diem, authorizes the Chairman to approve interstate branches, authorizes entering into sharing agreements with other governmental entities, and extends the examination cycle from 30 to 36 months, has been heard by the Committee, approved, and will likely come up for a vote on the House floor possibly next week.

Chairman Karsky indicated another issue arose that he wanted the Board's advice on, which is that there is a state-chartered credit union that has expressed a desire to convert or be able to convert to a state-chartered thrift; noting that the statute for state-chartered thrifts is extremely outdated. Chairman Karsky indicated in order to accomplish this the Department will need to update the statute which will involve the Department staff as well as the Department's attorney's time, will have to develop an examination, and have examiners trained to conduct examinations of thrift institutions, all of which will cost money. Chairman Karsky stated the question is who should cover the costs of this since all of the

Department's divisions are self-funding – should it be the credit union industry, the banking industry, or the state-chartered thrift industry.

Member Braseth asked who they would pay their fees to, and Chairman Karsky stated they would pay the fees to the Department; however, it would likely be a separate division funded by the thrift industry.

Members Braseth and Monson both concurred that the industry should support itself, and Member Moldenhauer agreed.

Chairman Karsky indicated in speaking with the representatives of the North Dakota Bankers Association, they indicated they are supportive of a conversion from a state-chartered credit union to a state-chartered thrift; however, there are members of the North Dakota Bankers Association that are national banks who do not pay fees to the Department and would be supportive of the banking division picking up the fees for updating the laws and creating the examination, as well as providing examiner training. Chairman Karsky indicated if the banking industry is supportive of the banking division picking up the costs, it does not effect the assessments for national banks; therefore, the state-chartered banks would essentially be covering the costs for this new updated charter.

Chairman Karsky noted that the State Banking Board would supervise the thrift industry and they would set the fees.

Member Henke indicated that is going to be a very expensive administrative bill for one entity to absorb if there is only one state-chartered thrift, whereas the fees for the administrative overhead for a state-chartered bank are spread over approximately 80 banks.

Member Braseth asked if there would be any more conversions other than this one credit union, and Chairman Karsky stated it depends on who you talk to; there could be anywhere from 0 to 6 more conversions.

Chairman Karsky indicated that realistically the federal charter is more advantageous because of the preemption of state laws and the ability to branch nationwide.

Member Quale stated she is confused as to why there is a need to convert, and Chairman Karsky indicated this particular credit union is limited to the amount

of member business loans they can make because of federal credit union law; therefore, converting to a thrift would enable him to make more business loans.

Member Henke pointed out that credit unions such as St. Alexius Community Credit Union and Capital Credit Union are limited by the federal law which Chairman Karsky described; however, there are some credit unions that are able to make as many member business loans as they want. Chairman Karsky stated that is correct; there are some credit unions that did get a member business loan waiver based on their original charters, which included making agricultural loans.

Member Braseth asked Chairman Karsky what he felt the cost could be to update the laws and provide the training, and Chairman Karsky stated he thought it could be $20,000-$30,000. Member Braseth stated that would be quite a tax on the state-chartered banks.

INDEPENDENT TRUST COMPANY APPLICATION

Assistant Commissioner Entringer discussed a potential new independent trust company charter transaction with the State Banking Board, describing how the proponents would like to accomplish the transaction. The question asked of the State Banking Board is whether they wanted to set a precedent given that there is nothing within state law that says the transaction could not be approved and consummated as described by Assistant Commissioner Entringer. Assistant Commissioner Entringer indicated Assistant Attorney General Webb reviewed the proposed transaction and indicated he found no reason why the State Banking Board could not act on it as contemplated, but questioned whether the State Banking Board would want to set that type of precedent.

Member Monson indicated as long as it meets the statutory criteria for approval he did not see any reason the Board could not go forward with the transaction and approve it is contemplated.

The Board agreed they had no problems with the transaction as contemplated provided that it is set forth in the notice and that the public is not misled.

MARCH MEETING/HEARING DATES

It was agreed to change the meeting date from March 1, 2007, to March 6, 2007, to accommodate a new bank charter hearing application for BlackRidge Financial, Inc., Fargo.

A hearing date was set for March 29, 2007, for the Turtle Mountain State Bank charter application in Belcourt.

The Board went into closed session at 10:33 a.m.

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