

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

November 13, 2014

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 Entringer called the meeting to order at 9:01 a.m., Thursday, November 13, 2014, by conference call.

MEMBERS PRESENT: Robert J. Entringer, Chairman (*Office*)
Nancy Baerwald, Member (*Cando*)
Linda Beall, Member (*Velva*)
Kim Larson, Member (*Casselton*)
John Schmid, Member (*Carson*)
Tom Stennes, Member (*Office*)
Cheryl Thompson, Member (*Fargo*)

MEMBERS ABSENT: None

ALSO PRESENT: Aaron Webb, Secretary (*Office*)
Suzette Richardson, Administrative Staff Officer (*Office*)
Dana Ereth, Eide Bailly (*Office*)
Gary Petersen, Lakeside State Bank (*Office*)
Nancy Petersen, Lakeside State Bank (*Office*)

APPROVAL OF MINUTES

Chairman Entringer indicated the Board received copies of the minutes of the regular meeting held on September 11, 2014, and the special meeting held on October 13, 2014.

It was moved by Member Schmid, seconded by Member Larson, and unanimously carried, to approve the minutes of the regular meeting held September 11, 2014, and of the special meeting held October 13, 2014, as presented.

CHANGE OF CONTROL APPLICATION – CORNERSTONE HOLDING COMPANY, FARGO

Assistant Commissioner Webb indicated the Department received the change of control application on September 29, 2014, for Gary Petersen individually to acquire 35.61% control of the voting stock of Cornerstone Holding Company, Inc., Fargo, North Dakota (CHC); and Gary Petersen, Brian Petersen, Jane Swenson, and Scott Swenson as a group to acquire control of 69.79% of the voting stock of CHC.

Assistant Commissioner Webb indicated notice of the application was published in the McKenzie County Farmer on September 24, 2014; the New Town News on September 26, 2014; and the Fargo Forum on September 29, 2014.

Assistant Commissioner Webb reviewed the provisions of Section 6-08-08.1 of the North Dakota Century Code regarding the change of control application.

Assistant Commissioner Webb indicated CHC is requesting permission to merge with Lakeside Bank Holding Company, New Town, North Dakota (LBHC); adding that this request is being made in connection with the simultaneous merger of Lakeside State Bank, New Town; McKenzie County Bank, Watford City; and Cornerstone Bank, Fargo, which will together operate as Cornerstone Bank.

Assistant Commissioner Webb indicated as a result of the holding company merger, the surviving entity would operate as CHC. Assistant Commissioner Webb noted that CHC currently has 230,402 shares outstanding, and following the proposed merger, an additional 532,237 shares issued to the former shareholders of LBHC will be added, for a total of 762,639 shares.

Assistant Commissioner Webb indicated since the merger would result in various shareholders of the former LBHC controlling greater than 25% of the voting stock of the surviving CHC; specifically, Gary Petersen would individually acquire 35.61% control of the voting stock, and Gary Petersen, Brian Petersen, Jane

Swenson, and Scott Swenson as a group to acquire control of 69.79% of the voting stock.

Chairman Entringer added that Dana Ereth provided responses to each of the items on the Department's checklist regarding a change of control application.

Assistant Commissioner Webb indicated the Department recommends that the change of control application be approved authorizing Gary Petersen individually and Gary Petersen, Brian Petersen, Jane Swenson, and Scott Swenson as a group to control 25% or more of the voting shares of CHC.

It was moved by Member Baerwald, seconded by Member Stennes, and carried by a vote of 6 to 1, with Member Thompson voting no, to approve the change of control application authorizing Gary Petersen individually and Gary Petersen, Brian Petersen, Jane Swenson, and Scott Swenson as a group to control 25% or more of the voting shares of Cornerstone Holding Company, Inc., Fargo, North Dakota.

MERGER APPLICATION – LAKESIDE STATE BANK, NEW TOWN, TO MERGE WITH MCKENZIE COUNTY BANK, WATFORD CITY, AND CORNERSTONE BANK, FARGO

Assistant Commissioner Webb indicated the Department received the merger application on September 10, 2014, for Lakeside State Bank, New Town (LSB), to merge with McKenzie County Bank, Watford City (MCB), and Cornerstone Bank, Fargo (CB), and to continue operations under the charger and name Cornerstone Bank, Fargo.

Assistant Commissioner Webb indicated notice of the application was published pursuant to the joint state and federal requirements in the McKenzie County Farmer on September 10, September 17, and October 1; in the New Town News on September 12, September 19, and October 3; and in the Fargo Forum on September 15, September 22, and October 6. Assistant Commissioner Webb indicated the public comment period ended no later than October 13, 2014, and no comments were received nor were there any requests for copies of the application.

Assistant Commissioner Webb indicated the applicant in this bank merger is LSB; however, as a result of the merger, LSB would join with MCB, and CB, and the resultant institution would continue to operate under the existing name and charter of Cornerstone Bank, Fargo.

Assistant Commissioner Webb reviewed the provisions of Section 6-03-11 of the North Dakota Century Code, and Chapter 13-02-13 of the North Dakota Administrative Code regarding mergers or consolidations.

Assistant Commissioner Webb indicated Notice of Special Meeting of Shareholders of CHC dated August 19, 2014, and Notice of Special Meeting of Shareholders of LBHC dated August 1, 2014, were included in the merger application.

Assistant Commissioner Webb indicated shareholder minutes dated September 2, 2014, from LBHC (as sole shareholder of both LSB and MCB), and CHC (as sole shareholder of CB) approving and ratifying the Agreement and Plan of Reorganization and Merger were included in the merger application.

Assistant Commissioner Webb indicated the required pro forma statements, as well as names of the directors and officers of the resultant institution were included in the merger application.

Assistant Commissioner Webb indicated LSB provides that the proposed merger will make banking services more convenient for customers within the service area, and will serve to expand mortgage services and products to all markets.

Assistant Commissioner Webb stated application materials detail the projected capital of the resultant bank on a pro forma basis as of June 30, 2014, and year-end through December 31, 2025. Assistant Commissioner Webb stated the resultant bank is projecting to remain in the "Well Capitalized" capital category.

Assistant Commissioner Webb stated the basic banking services now offered by LSB, MCB, and CB in the communities and areas served will not be diminished in any respect with the approval of the application; adding that copies of each bank's current CRA Performance Evaluations that outlines current services provided by each institution are included in the application.

In regard to the adequacy and competence of management, Assistant Commissioner Webb indicated the Department has no information that would indicate the proposed officers are not qualified, experienced or financially responsible.

Assistant Commissioner Webb reviewed the provisions of Section 6-03-13.3 of the North Dakota Century Code, which provides in part that upon approval of a merger application the former main office and facilities of the banking institutions being merged will become facilities of the surviving banking institution and the banking institution is not required to file a facility application. Assistant Commissioner Webb added that the resultant institution intends to continue operations in all existing offices of the three banks, as outlined in the application.

Dana Ereth explained the uniqueness of this application is it is a true merger application as there is no cash consideration or debt associated with the merger.

Mr. Ereth indicated under the Federal Reserve Bank Holding Company Act criteria, the initial discussions were to consider the current environment; due diligence discussions between the parties; vendor management; and interest rate risk policies, processes and procedures.

Mr. Ereth explained each of the three banks involved in the merger have outside parties providing analysis, as well as CB providing an internal analysis by ProfitStar, in order to continue review of interest rate risk as requested by the Federal Reserve (FR).

Mr. Ereth indicated both the Federal Deposit Insurance Corporation (FDIC) and FR are concentrating on fair value and pushdown accounting adjustments. Mr. Ereth explained original discussions with the FDIC, taking into consideration accounting perspective rules, were that the applicant for the bank merger would be LSB and CB the target. Mr. Ereth explained that is how the original application was submitted; however, after submitting the change of control application to the FR, discussion between the FDIC, FR, and banks resulted in the CB being targeted as the applicant.

Mr. Ereth indicated when identifying the target in a business consolidation or merger it will be subject to pushdown accounting, whereby a participant's balance sheet will be fair valued. Mr. Ereth explained since the accounting criteria identified CB as the target, their balance sheet was implemented by fair value

adjustments. Mr. Ereth continued the three banks will simultaneously merge; however, CB's balance sheet was revised with the fair value adjustments before the book values of LSB and MCB were combined. Mr. Ereth explained contact with outside parties is in process to perform the fair value adjustments.

Mr. Ereth continued the FR noted the consolidated holding company will be over \$500 million; therefore, there will be a shift from small bank to large bank capital standards. Mr. Ereth indicated the FR has requested five-year consolidated holding company capital ratios.

Mr. Ereth stated that the FDIC reviewed the capital of the banks, with the result being approximately an 8% primary capital ratio, and stabilizing in 2016. Mr. Ereth indicated the projections were very conservative with strong deposit growth projected out of the Watford City and New Town markets; as well as runoff and higher costs of funds in the Bismarck and Fargo markets.

Mr. Ereth indicated three bank line items projected for the next two years were performed, as well as ten-year period averages. Mr. Ereth stated he feels the earnings potential of the combined banks is very conservative.

Mr. Ereth stated the proposed merger process was very smooth; adding that the three banks used one attorney and accounting firm through the application process. Mr. Ereth continued the question of merger by equals has not been an issue.

Mr. Ereth indicated the change of control application presented to the FR is identified as a merger of holding companies and simultaneous merger of banks; however, explained the merger of the banks could occur at a later date, due to IT conversion. Mr. Ereth explained he did not request a waiver from the FR regarding the holding company merger even though there is the possibility of the banks merging at a later date.

Mr. Ereth explained there could be a potential three-month delay, as the holding company change of control would become effective December 31, 2014, with a final tax return for LBH; and a first quarter 2015 conversion merger of the banks, pending the IT conversion. Mr. Ereth indicated the FR does not have a problem with this process; adding this will be discussed with the FDIC once a more definite conversion date is known.

In response to Chairman Entringer, President Petersen indicated the bank merger application is scheduled on the FDIC calendar for March 14 and 22, 2015.

Mr. Ereth stated because the IT conversion would be at a later date, the individual banks will continue to run their own systems with a combined call report period.

In response to Chairman Entringer, Mr. Ereth indicated the FDIC has approved the merger application, with a ten-day waiting period pending Department of Justice review.

Mr. Ereth indicated some advantages of this transaction are no overlapping markets, the strength of a management team to assist with the growth in the McKenzie and New Town markets, and combination of the Boards of Directors. Mr. Ereth continued that LSB is controlling this transaction and resulting in more than two-thirds of the stock upon merger of the holding companies; as well as controlling the Board of Directors of both the merged bank and holding company. Mr. Ereth indicated there will be combined management expertise, increased capital, no overlapping markets, and more services available in the McKenzie and New Town markets.

Mr. Ereth explained there was the possibility of losing tax attributes of CHC, so after discussion with both the IRS and North Dakota Tax Department the decision was to proceed with retaining the charter of CB. Mr. Ereth indicated CB has had some losses in the past which will be eliminated through the merger.

Mr. Ereth concluded it is a very complex transaction combining small banks with a large bank.

In response to Member Thompson, Mr. Ereth indicated from an accounting perspective the proposed merger should be enhanced because CB will have the availability of lower costs of funds from the New Town and Watford City markets; therefore, the ability to increase the earnings capacity of CB locations in a bank regulatory environment comes more freedom to compete. Mr. Ereth continued that CB is relatively new to the Fargo market; therefore, the deposits attracted are usually coming in at a premium due to the competition. Mr. Ereth explained through this merger the abundance of deposits from the New Town and Watford City market areas will better utilize the Bismarck and Fargo market loan demand

perspective and provide the ability to lower the overall cost of funds in the Fargo and Bismarck markets. Mr. Ereth concluded these areas will enhance the ability of CB to compete with the larger and more established institutions in the Fargo and Bismarck market areas.

In response to Member Thompson, President Petersen indicated the community response in Parshall, New Town, and Watford City has been remarkable and overwhelming positive. President Petersen stated he believes people felt differently about their community bank 20 years ago; adding that with the situation in western North Dakota, people have realized that change happens. President Petersen indicated when visiting with his customers, the reasons for the merger became clear; adding the knowledge that the Petersen family retains overall ownership control and a majority on the boards of both the holding company and resultant bank has provided comfort that the bank will continue to be a community bank that is very market oriented. President Petersen indicated in early conversations regarding ownership and management, the commitment to serving the local markets was a priority. President Petersen continued that market presidents will have major authority, with good oversight by the boards. Mr. Petersen concluded he believes this merger is a win/win for all the markets involved.

Chairman Entringer added that going from an approximate \$200 million bank to an approximate \$800 million bank the lending limit increases significantly; therefore, the resultant bank will have a much larger lending limit which will enable handling larger credits.

In response to Member Thompson's question regarding merging the operations of the three banks and whether employees would be eliminated, President Petersen indicated the home office would be based in Fargo; however, the work needed to be done can occur in any of the locations. President Petersen agreed that CB has a larger people infrastructure and more precise technology; therefore, some of that process will take place in Fargo. President Petersen added there is an extreme need for employees in western North Dakota; therefore, those market areas will be able to leverage their ability to bring in professionals working in the Bismarck and Fargo areas. President Petersen noted that two current Watford City employees will remain Watford City while assuming higher level positions, which enhances both the resultant bank and those employees.

Member Thompson commented she had a better understanding of the proposed transaction through conversations with President Petersen and Mr. Ereth.

Mr. Ereth addressed the question of what CB achieves in this transaction since three controlling shareholders that own approximately 90% of CHC will relinquish that control to the Petersen family. Mr. Ereth explained that CB saw the ability for them to become more competitive in the Bismarck and Fargo market areas.

In response to Member Stennes, President Petersen indicated AccuData is no longer providing services for LSB and MCB, and these banks migrated to FiServe in September 2014, the same company used by CB.

Mr. Ereth stressed the commitment levels of all parties for this transaction to succeed and the resultant bank to grow.

Assistant Commissioner Webb indicated it is the Department's opinion all of the criteria have been met; the assumptions used and projections provided in the application are accurate; and would recommend that the merger application be approved, and that the Commissioner be authorized to sign the proposed Order on behalf of the Board.

Chairman Entringer reviewed with the Board the changes made to the proposed Order, as well as outlining the requirements contained in the Order.

It was moved by Member Larson, seconded by Member Schmid, and unanimously carried to approve the application for Lakeside State Bank, New Town, to merge with McKenzie County Bank, Watford City, and Cornerstone Bank, Fargo, and to continue operations under the charger and name Cornerstone Bank, Fargo; and that Chairman Entringer be authorized to sign the Order on behalf of the Board.

President Petersen thanked the Department staff for their constructive approach regarding the merger application, as well as the Board for their consideration and approval.

Dana Ereth, Gary Petersen, and Nancy Petersen left the meeting at 9:50 a.m.

ITEM TO BE NOTED

Chairman Entringer indicated that on September 22, 2014, he approved, as Commissioner, the request by American Bank Center, Dickinson, to establish a facility at 101 East Main Street, Mandan.

BANK BUDGET UPDATE

Chairman Entringer reviewed the September 30, 2014, Organizational Status Report by Summary Account for the bank division.

LEGISLATION

Chairman Entringer indicated he and Assistant Commissioner Webb met with representatives of the North Dakota Bankers Association (NDBA) and the Independent Community Banks of North Dakota (ICBND) to review proposed bank legislation; and will be meeting with the NDBA Legislative Committee following this meeting.

Chairman Entringer indicated it was clear the Board was not in favor of the legislation granting the Department authority to examine bank holding companies; however, agreed that the Department seek authority to impose civil money penalties, removal authority, and the ability to issue an Order against a holding company.

Chairman Entringer reviewed the bill drafted by the Department which creates Section 6-01-4.5, entitled Investigation of bank holding companies.

Member Schmidt agreed as long as this legislation is used for regulatory purposes, not regulatory compliance.

Chairman Entringer reviewed the proposed updates to Sections 6-01-04.4, 6-01-09, 6-03-47.2, and 6-08-08.1.

Chairman Entringer explained Section 6-01-04.4 will be changed to add “in effect on July 1, 2005”, which is when this Section was last updated; this allows authority of the statute as it currently exists.

Chairman Entringer explained Section 6-01-09 will be amended to grant authority to the Department to examine third party technology service providers. In response to Member Beall, Chairman Entringer indicated if this proposed amendment is approved, the Department would have the authority to examine these types of service providers; however, the Department does not currently have the staff expertise to be involved in these types of examinations and would participate in joint examinations with federal counterparts.

Chairman Entringer explained the proposed amendment to Section 6-03-47.2 is to add “the face value of” regarding investments, which will eliminate the Department having to cite minor violations.

Chairman Entringer explained the proposed amendments to Section 6-08-08.1: delete the language that requires the Board take action when there is a sale or otherwise disposition of an association, since this language is not in the federal law; add the language “or the next regularly scheduled meeting of the board”, so the sixty day timeframe is not the only option; add the federal law exemptions regarding a gift, inheritance, or acquisition of voting securities by debts previously contracted, as well as providing the Commissioner the authority to require an application if not within the listed exemptions, which would be acted on by the board.

In response to Member Beall, Chairman Entringer indicated an application is not required if a shareholder owns more than 25%; however, if a shareholder owns 23% and is gifted additional shares, an application is currently required if they go above 25%

Chairman Entringer agreed with Member Stennes that this proposed amendment also eliminates a change of control application in the event a shareholder owning 25% gifts shares and now owns less than 25%.

Chairman Entringer indicated the Department is proposing to repeal Section 6-05-25 which allows a trust company to inject its capital stock over a two-year period. Chairman Entringer explained capital must be in place before a bank is chartered and believes it should be the same for a trust company.

In response to Member Stennes, Chairman Entringer indicated a CSBS Committee is reviewing the capitalization and bonding requirements of independent trust companies.

MEETING DATE FOR 2015

Chairman Entringer indicated the proposed meeting dates for 2015 are January 8, March 12, May 14, July 9, September 10, and November 12; adding that these dates can be changed if necessary.

It was moved by Member Beall, seconded by Member Thompson, and unanimously carried to approve the 2015 meeting dates of January 8, March 12, May 14, July 9, September 10, and November 12.

The Board went into closed session at 9:38 a.m. to review the Supervisory Reports of Examination pursuant to North Dakota Century Code 6-01-07.1, and to discuss any confidential records pursuant to North Dakota Century Code 44-04-19.2.

The Board reconvened to open session at 10:19 a.m.

SPECIAL MEETING

Chairman Entringer indicated a special meeting will be held to review an application the Department received from TS Contrarian Bancshares, Inc., Treynor, IA, to acquire 100% of the shares of Hanisch Bankshares LTD, Crosby, and thereby acquire control of Farmers State Bank of Crosby, and merge into The Bank of Tioga, by yearend 2014.

The meeting adjourned at 10:35 a.m.

Robert J. Entringer, Chairman

Aaron Webb, Secretary