

{{3-31-95 p.C-697}}

¶10,152] In the Matter of Peoples State Bank, Fairmount, North Dakota; Docket No. FDIC-90-256b (12-12-90).

Bank to cease and desist from operating with an excessive volume of adversely classified assets; engaging in hazardous lending and lax collection practices; engaging in management policies and practices which are detrimental to the Bank; operating with deficient loan documentation; engaging in practices which produce inadequate operating income and excessive loan losses; failing to provide adequate supervision over the affairs of the Bank; paying excessive cash dividends; operating with inadequate loan and lease loss allowance; and failing to submit Reports of Condition and Income as required. *(This order was terminated by order of the FDIC dated 1-17-95; see ¶15,953.)*

[.1] Management—Qualifications—Review

[.2] Management—Management Plan—Minimum Requirements—Review

[.3] Board of Directors—Committee to Review Compliance

[.4] Board of Directors—Election—Independent Directors Added

[.5] Definition—"Independent with Respect to the Bank"

[.6] Board of Directors—Meetings—Agenda and Minutes Required

[.7] Assets—Adversely Classified—Eliminate/Reduce

[.8] Capital—Equity Capital—Increase/Maintain

[.9] Allowance for Loan and Lease Losses—Maintain

[.10] Loans—Risk Position—Written Plan—Minimum Requirements—Review

[.11] Loans—Extensions of Credit—Existing Borrowers—Curtain

[.12] Loans—Accrual of Interest—Restrictions

[.13] Loan Policy—Revision—Minimum Requirements—Review

[.14] Profit Plan—Minimum Requirements—Review

[.15] Funds Management Policy—Minimum Requirements—Review

[.16] Dividends—Restricted

[.17] Accounting—Written Policy Required

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[.18] Technical Exceptions—Correct

[.19] Shareholders—Disclosure—Cease and Desist Order

[.20] Compliance—Progress Reports—Frequency

In the Matter of

**PEOPLES STATE BANK,
FAIRMOUNT, NORTH DAKOTA
(Insured State Nonmember Bank)
ORDER TO CEASE AND DESIST**

People State Bank, Fairmount, North Dakota ("Bank"), having been advised of its right to a Notice of Charges and of Hearing detailing the unsafe or unsound banking practices alleged to have been committed by the Bank and of its right to a hearing on such alleged charges under section 8(b) of the Federal Deposit Insurance Act, 12 U.S.C. § 1818(b), and having waived those rights, entered into a STIPULATION AND CONSENT TO THE ISSUANCE OF AN ORDER TO CEASE AND DESIST ("CONSENT AGREEMENT") with counsel for the Federal Deposit Insurance Corporation ("FDIC"), dated November 21, 1990, whereby solely for the purpose of this proceeding and without admitting or denying any unsafe or unsound banking practices, the Bank consented to the issuance of an ORDER TO CEASE AND DESIST ("ORDER") by the FDIC.

The FDIC considered the matter and determined that it had reason to believe that the Bank had engaged in unsafe or unsound banking practices. The FDIC, therefore, accepted the CONSENT AGREEMENT and issued the following:

ORDER TO CEASE AND DESIST

IT IS HEREBY ORDERED, that the Bank, its institution-affiliated parties, as that term is defined in Section 3(u) of the Act, 12 U.S.C. § 1813(u), and its successors and assigns cease and desist from the

following unsafe and unsound banking practices:

- A. operating with an excessive volume of adversely classified assets;
- B. engaging in hazardous lending and lax collection practices, including maintaining an excessive volume of adversely classified loans;
- C. engaging in management policies and practices which are detrimental to the Bank;
- D. operating with deficient or inadequate loan documentation, including but not limited to current financial statements, insurance coverage, title searches or legal opinions, and cash flow and/or operating information;
- E. engaging in practices which produce inadequate operating income and excessive loan and other asset losses;
- F. failing to provide adequate supervision and direction over the affairs of the Bank to prevent unsafe or unsound practices;
- G. paying excessive cash dividends in relation to the Bank's net income;
- H. operating with an inadequate allowance for loan and lease losses for the volume, kind and quality of loans held; and
- I. failing to submit Reports of Condition and Income in accordance with prevailing instructions.

IT IS FURTHER ORDERED, that the Bank, its institution-affiliated parties, and its successors and assigns, take affirmative action as follows:

[.1] 1. (a) (i) No more than 60 days from the effective date of this ORDER, the Bank shall have and thereafter retain qualified management. Such management shall include a qualified senior lending officer who shall be given stated written authority by the Bank's board of directors, including responsibility for implementing and maintaining the lending policies of the Bank. The senior lending officer shall have an appropriate level of lending, collections, and loan supervision experience to perform the duties assigned to that individual by the Bank's board of directors. The Bank shall promptly notify the Regional Director of the FDIC's Kansas City Regional Office ("Regional Director") of the identity of said senior lending officer. Prior to the addition of any individual to the board of directors or the employment of any individual as a senior executive officer, the Bank shall comply with the requirements of section 32 [{{2-28-91 p.C-699}}](#) of the Act, 12 U.S.C. § 1831i; and section 303.14 of the FDIC's Rules and Regulations, 54 Fed. Reg. 53040 and 53043 (to be codified at 12 C.F.R. §303.14).

(ii) The assessment of whether the Bank has "qualified management" shall be based upon management's conduct, both individual and joint, with respect to the Bank in: (A) complying with the requirements of this ORDER; (B) complying with applicable laws and regulations; and (C) not engaging in any unsafe or unsound banking practice which has an adverse effect on the Bank's asset quality, capital adequacy, earnings, or liquidity.

[.2] (b) The board of directors shall in no more than 30 days from the effective date of this ORDER develop a written analysis and assessment of the Bank's management and staffing needs ("management plan"), which shall include, at a minimum:

(i) identification of both the type and number of officer positions needed to manage and supervise properly the affairs of the Bank;

(ii) identification and establishment of such Bank committees as are needed to provide guidance and oversight to active management:

(iii) evaluation of each Bank officer, and in particular the chief executive officer, and staff member to determine whether these individuals possess the ability, experience and other qualifications required to perform present and anticipated duties, including adherence to the Bank's established policies and practices, and maintenance of the Bank in a safe and sound condition; and

(iv) a plan of action to recruit and hire any additional or replacement personnel with the requisite ability, experience and other qualifications, which the board of directors determines are necessary to fill Bank officer or staff member positions consistent with the board's analysis, evaluation and assessment as provided in paragraphs 1(b)(i) and 1(b)(iii) of this ORDER.

(c) The written management plan and any subsequent modification thereto shall be submitted to the Regional Director for review and comment. No more than 30 days from the receipt of any comment from the Regional Director, and after consideration of such comment, the board of directors shall approve the written management plan and/or any subsequent modification thereto which approval shall be recorded in the minutes of the board of directors. Thereafter, the Bank and its institution-affiliated parties shall implement and follow the written management plan and/or any subsequent modification thereto.

[.3] (d) (i) The written management plan shall also include the requirement that the board of directors of the Bank, or a committee thereof of 3 individuals consisting of not less than 2 individuals who are independent with respect to the Bank, provide supervision over lending, investment and operating policies of the Bank sufficient to ensure that the Bank complies with the provisions of this ORDER.

[.4] (ii) At the next meeting of the shareholders of the Bank, and at each succeeding meeting of the shareholders at which Bank directors are to be elected, the members of the board of directors who are also shareholders shall take all reasonable steps possible to nominate and support the election of candidates to the board of directors who are independent with respect to the Bank, in such number as are necessary to cause a majority of the board of directors to be and to remain independent with respect to the Bank. The Bank's board of directors shall maintain in its minutes a written record of any action taken by any director to comply with the requirements of paragraph 1(d)(ii) of this ORDER.

[.5] (iii) For purposes of this ORDER, an individual who is "independent with respect to the Bank" shall be any individual (1) who is not an officer of the Bank and who does not own more than 5 percent of the outstanding shares of the Bank, (2) who is not related by blood to the third degree or marriage to an officer of the Bank or to any stockholder owning more than 5 percent of the Bank's outstanding shares, (3) who is not indebted to the [{{2-28-91 p.C-700}}](#)Bank, directly or indirectly (including the indebtedness of any entity in which the individual has a material ownership interest), in an amount exceeding 10 percent of the Bank's total equity capital and allowance for loan and lease losses, or (4) is not employed by, or does not have a material ownership interest in, a related interest of an officer of the Bank or of any stockholder owning more than 5 percent of the Bank's outstanding shares.

(iv) As used in paragraph 1(d) of this ORDER, "related interest" means the same as defined in section 215.2(k) of Regulation O of the Board of Governors of the Federal Reserve System ("Regulation O"), 12 C.F.R. § 215.2(k).

[.6] (e) Effective the date of this ORDER, the Bank's board of directors shall prepare in advance and shall follow a detailed written agenda at each board meeting, which shall include consideration of actions of any committees. Nothing in the foregoing sentence shall preclude the board from considering matters other than those contained in the agenda. Detailed written minutes of all board meetings shall be maintained and recorded on a timely basis.

[.7] 2. No more than 10 days from the effective date of this ORDER, the Bank: (a) shall eliminate from its books, by charge-off, collection, or other proper entries, all assets or portions of assets classified "Loss" as of May 1, 1990; and (b) shall either (i) eliminate from its books by charge-off, collection, or other proper entries, or (ii) if the asset is an extension of credit or lease, increase its allowance for loan and lease losses by an amount equal to 50 percent of those assets or portions of assets classified "Doubtful" as of May 1, 1990, which have not been previously collected, charged off, or otherwise eliminated by other proper entries. Reduction of these assets through use of proceeds of loans made by the Bank does not constitute collection for the purpose of this paragraph.

[.8] 3. (a) (i) During the period this ORDER is in effect, the Bank shall have total equity capital, exclusive of the allowance for loan and lease losses required to be maintained in accordance with paragraph 4 of this ORDER, at or in excess of 6 percent of the Bank's total assets ("equity capital ratio") and shall thereafter maintain its equity capital ratio at or in excess of such level as calculated herein while this ORDER is in effect. The terms "equity capital" and "total assets" shall have the same meaning as those terms have in the prevailing Instructions for Preparation of Reports of Condition and Income ("Instructions").

(ii) The equity capital ratio shall be calculated as of Report Date, as that term is used in the Instructions. For the purpose of calculating the equity capital ratio as of a given Report Date:

(A) total equity capital shall be the amount of total equity capital required to be included in the Bank's Report of Condition for the Report Date;

(B) total assets shall be the average of total assets required to be included in the Bank's Report of Condition for the Report Date and is found in the Call Report Schedule of quarterly averages;

(C) total equity capital and total assets reported in the Bank's Report of Condition are to be calculated in accordance with the prevailing Instructions; and

(D) the Bank shall have an adequate allowance for loan and lease losses in accordance with paragraph 4 of this ORDER.

(b) If, during the period this ORDER is in effect, the equity capital ratio, exclusive of the allowance for

loan and lease losses, declines below 6 percent, the Bank, within 30 days after the date on which the said ratio so declined, shall develop and implement a written plan to increase such ratio up to or in excess of 6 percent. No more than 60 days after the implementation of the written plan, the Bank's equity capital ratio, exclusive of the allowance for loan lease losses, shall equal or exceed 6 percent and the Bank shall thereafter maintain its equity capital ratio at or in excess of such level as calculated herein while this ORDER is in effect.

(c) The Bank's board of directors shall maintain in its minutes a written record of all actions taken by the Bank to comply with the capital requirements of paragraphs 3(a) through 3(b) of this ORDER.

[.9] 4. (a) The Bank shall maintain an allowance for loan and lease losses in {{2-28-91 p.C-701}} accordance with the prevailing requirements of the Instructions.

(b) Reports of Condition and Income required to be submitted by the Bank as of each Report date, as that term is used in the Instructions, between and including May 1, 1990, and the effective date of this ORDER, shall, at a minimum, reflect an allowance for loan and lease losses that should have been maintained in accordance with the Instructions. If necessary to comply with this paragraph, the Bank shall file amended Reports of Condition and Income within 10 days from the effective date of this ORDER.

(c) Prior to the submission of any Report of Condition or Report of Income required to be filed by the Bank after the effective date of this ORDER, the board of directors of the Bank shall: (i) review the adequacy of the Bank's allowance for loan and lease losses, (ii) provide for an adequate allowance, and (iii) accurately report the allowance in any such Report of Condition and Income. The minutes of the board meeting at which such review is undertaken shall indicate the results of the review, including any increases in the allowance, and the basis or determining the amount of allowance provided.

[.10] 5. (a) Within 60 days from the effective date of this ORDER, the board of directors shall develop a written plan of action to lessen the Bank's risk position in each line of credit aggregating \$25,000 or more which was classified "Substandard" or "Doubtful" as of May 1, 1990. In developing such plan, the Bank shall, at a minimum:

(i) review the financial position of each such borrower, including source of repayment, repayment ability, and alternative repayment sources; and

(ii) evaluate the available collateral for each such credit, including possible actions to improve the Bank's collateral position. Based upon such review and evaluation, the written plan of action shall: (A) establish target dollar levels to which the Bank shall reduce the aggregate dollar volume of "Substandard" or "Doubtful" classifications within 6 and 12 months from the effective date of this ORDER; and (B) provide for the submission of written monthly progress reports to the Bank's board of directors for review and notation in the board minutes. As used in this paragraph, "reduce" means to (1) collect, (2) charge off, or (3) improve the quality of such assets so as to warrant removal of any adverse classification by the FDIC.

(b) The written plan of action described by paragraph 5(a) and any subsequent modification thereto shall be submitted to the Regional Director and the Commissioner of Banking and Financial Institutions for the State of North Dakota ("Commissioner") for review and comment. No more than 30 days after the receipt of any comment from the Regional Director, the board of directors shall approve the written plan of action, which approval shall be recorded in the minutes of the board of directors. Thereafter, the Bank and its institution-affiliated parties shall follow the written plan of action and/or any subsequent modification.

[.11] 6. (a) Effective the date of this ORDER, the Bank shall not extend, directly or indirectly, credit to, or for the benefit of, any borrower who has a loan or other extension of credit with the Bank that has been charged off or classified, in whole or in part, "Loss," "Doubtful," or "Substandard," and is uncollected, unless a majority of the Bank's board of directors first (a) determines that such advance is in the best interest of the Bank, (b) determines that the Bank has satisfied the requirements set out in paragraph 5 of this ORDER as to such borrower, and (c) approves such advance. A written record of the board of directors' determination and approval of any advance under the terms of this paragraph shall be maintained in the credit file of the affected borrower(s) as well as the minutes of the board of directors. The requirements of this paragraph do not prohibit the Bank from renewing any credit already extended to the borrower.

[.12] (b) Effective the date of this ORDER, the Bank shall not add accrued interest to the principal balance of, or advance funds in the form of new extensions of credit to pay previously accrued but unpaid interest on, any extension of credit, which is or has been:
{{2-28-91 p.C-702}}

- (A) charged off, in whole or in part,
- (B) criticized, in whole or in part, "Loss," "Doubtful," "Substandard" or "Special Mention," or
- (C) 90 days or more delinquent as to principal and interest and not both well secured and in the process of collection.

The requirements of this paragraph do not include any other extension of credit, provided that, prior to any such addition of interest or any such new advance, a majority of the Bank's board of directors first (1) determines such action is warranted by the affected loan's credit quality or prospects for repayment, and (2) approves such addition of accrued interest or such new advance. A written record of the board of directors' determination and approval of any action under the terms of this paragraph, including an explanation of the basis and specific reasons for such action, shall be maintained in the credit file of the affected borrower(s) as well as the minutes of the board of directors.

(c) As used in this ORDER, "extension of credit" means the same as defined in section 215.3 of Regulation O, 12 C.F.R. § 215.3.

[.13] 7. (a) No more than 60 days from the effective date of this ORDER, the Bank shall revise its written loan policy which revision shall include, at a minimum:

- (i) the lending authority of the loan officer,
- (ii) the lending authority of a loan or executive committee, if any;
- (iii) the responsibility of the board of directors in reviewing, ratifying and approving loans;
- (iv) the guidelines under which unsecured loans will be granted;
- (v) the guidelines for rates of interest and terms of repayment for unsecured loans and secured loans;
- (vi) with regard to secured loans: (A) limitations on the amount advanced in relation to the value of the collateral, and (B) the documentation required by the Bank for each type of secured loan;
- (vii) the maintenance and review of complete and current credit files on each borrower;
- (viii) appropriate and adequate collection procedures, including, but not limited to, the actions to be taken against borrowers who fail to make timely payments;
- (ix) guidelines establishing limitations on the maximum volume of loans in relation to total assets;
- (x) appropriate limitations on extension of credit through overdrafts and cash items;
- (xi) the determination and documentation of sources and terms of loan repayment;
- (xii) retention of lien searches and appraisals covering personal property and liens on real estate;
- (xiii) maintenance of written, individual loan file comments by officers;
- (xiv) provisions addressing the capitalization of accrued and unpaid interest on loans;
- (xv) procedures regarding designations of nonaccrual loans;
- (xvi) procedures for identifying, supervising, and collecting problem loans;
- (xvii) periodic review of the overdue, problem and/or adversely-classified or special-mention loans by the directorate, so as to monitor management's administration of such distressed credits, and to provide guidance.

(b) The revised written loan policies and any subsequent modification thereto shall be submitted to the Regional Director and the Commissioner for review and comment. No more than 30 days after the receipt of any comment from the Regional Director, the board of directors shall approve the written loan policies and/or any subsequent modification thereto, which approval shall be recorded in the minutes of the board of directors. Thereafter, the Bank and its institution-affiliated parties shall follow the written loan policies and/or any subsequent modification thereto.

[.14] 8. (a) No more than 60 days from the effective date of this ORDER, the Bank shall develop a written profit plan consisting of goals and strategies for improving the earnings of the Bank, which written profit plan shall include, at a minimum:

[{{2-28-91 p.C-703}}](#)

- (i) identification of the major areas in, and means by, which the board of directors will seek to improve the Bank's operating performance;
- (ii) realistic and comprehensive budgets;
- (iii) a budget review process to monitor the income and expenses of the Bank to compare actual figures with budgetary projections; and
- (iv) a description of the operating assumptions that form the basis for, and adequately support, major projected income and expense components.

(b) The written profit plan and any subsequent modification thereto shall be submitted to the Regional Director and the Commissioner for review and comment. No more than 30 days after the receipt of any comment from the Regional Director, the board of directors shall approve the written profit plan and any subsequent modification thereto, which approval shall be recorded in the minutes of the board of directors. Thereafter, the Bank and its institution-affiliated parties shall follow the written profit plan and/or any subsequent modification thereto.

[.15] 9. (a) No more than 60 days from the effective date of this ORDER, the Bank shall develop a written funds management policy which shall include, at a minimum:

(i) establish adequate recordkeeping systems to track the volume of (A) rate-sensitive assets and (B) rate-sensitive liabilities. Rate-sensitive assets and liabilities are generally defined as those that either mature or can be repriced during a specified time period (90 days, 180 days, 1 year);

(ii) establish a range of acceptable ratios for rate-sensitive assets to rate-sensitive liabilities sufficient to protect the bank against excessive interest-rate risk and ensure that an adequate net interest margin is maintained;

(iii) establish adequate recordkeeping systems to track the volume of (A) stable or core deposits and (B) volatile deposits;

(iv) establish guidelines for offsetting a substantial portion of the bank's volatile deposits and borrowings with liquid, short-term assets;

(v) establish investment guidelines for funds derived from negotiable-rate certificates of deposit and borrowings, including a maximum large liability dependency ratio. A large liability dependency ratio means the percentage of loans plus other long-term earning assets that may be funded by negotiable-rate certificates of deposit and borrowings;

(vi) establish a range of acceptable loan-to-deposit ratios, taking into account seasonal deposit fluctuations;

(vii) establish a borrowing policy which addresses: (A) when or under what conditions the bank may borrow, (B) maximum amounts that may be borrowed, (C) a list of acceptable creditors, and (D) which officers are authorized to borrow;

(viii) establish contingency plans for meeting large, unexpected withdrawals, which should include: (A) curtailing lending activity with priority given to specific types of credit and (B) establishing lines of credit with other financial institutions which will advance funds on short notice; and

(ix) establish a funds-management committee to meet at least monthly to determine how best to allocate the bank's available funding sources among various asset categories after reviewing: (A) the bank's liquidity position, (B) outstanding commitments such as loan commitments and letters of credit, and (C) the bank's rate-sensitivity position and net interest margin.

(b) The funds management policy shall be coordinated with the Bank's loan, investment, operating, and budget and profit planning policies.

(c) The written funds management policy and any subsequent modification thereto shall be submitted to the Regional Director and the Commissioner for review and comment. No more than 30 days from the receipt of any comment from the Regional Director, the board of directors shall approve the written funds management policy and any subsequent modification thereto, which approval shall be recorded in the minutes of the

[\[2-28-91 p.C-704\]](#)board of directors. Thereafter, the Bank and its institution-affiliated parties shall follow the written funds management policy and/or any subsequent modification thereto.

[.16] 10. The Bank shall not declare or pay cash dividends in any amount unless:

(a) Such declarations and payments are made in accordance with applicable State and Federal laws and regulations;

(b) After payment of such dividends, the Bank's equity capital ratio shall be not less than that required in paragraph 3(a)(i) of this ORDER and the Bank's allowance for loan and lease losses shall be materially adequate as described in paragraph 4 of this ORDER;

(c) Such declaration and payment of dividends shall be approved in advance by the board of directors of the Bank, which approval shall be recorded in the minutes of the board of directors; and

(d) At least 30 days prior to the declaration of a cash dividend, written notice of the intention to declare such dividend shall be given to the Regional Director and the Commissioner for review and comment.

[.17] 11. (a) No more than 30 days from the effective date of this ORDER, the Bank shall develop a

written policy for accounting for and recording depreciation on fixed assets which requires, among other things, that the original costs of its fixed assets be allocated over their useful lives and recorded on the Bank's books in accordance with Generally Accepted Accounting Principles ("GAAP"). Thereafter, the Bank and its institution-affiliated parties shall follow the written depreciation policy and/or any subsequent modification thereto.

(b) Reports of Condition and Income required to be submitted by the Bank as of each Report date, as that term is used in the Instructions, between and including December 31, 1989, and the effective date of this ORDER, shall, at a minimum, reflect a depreciation expense for fixed assets in accordance with the Instructions and GAAP. If necessary to comply with this paragraph, the Bank shall file amended Reports of Condition and Income within 45 days from the effective date of this ORDER.

[.18] 12. No more than 60 days from the effective date of this ORDER, the Bank shall correct the technical exceptions on loans noted on pages 2-d through 2-d-2 of the FDIC's Report of Examination of the Bank as of May 1, 1990.

[.19] 13. Following the effective date of this ORDER, the Bank shall send to its shareholders a description of this ORDER, (a) in conjunction with the Bank's next shareholder communication, and also (b) in conjunction with its notice or proxy statement preceding the Bank's next shareholder meeting. The description shall fully describe the ORDER in all material respects. The description and any accompanying communication, statement, or notice shall be sent to the FDIC, Registration and Disclosure Unit, Washington, D.C. 20429, for review at least 20 days prior to dissemination to shareholders. Any changes requested to be made by the FDIC shall be made prior to dissemination of the description, communication, notice, or statement.

[.20] 14. The Bank shall furnish written progress reports to the Regional Director and the Commissioner detailing the form and manner of any action taken to secure compliance with this ORDER and the results thereof every 90 days, beginning 90 days from the effective date of this ORDER. In addition, the Bank shall furnish such reports on request of either the Regional Director or the Commissioner. All progress reports and other written responses to this ORDER shall be reviewed by the board of directors of the Bank and made a part of the minutes of the board meeting.

This ORDER shall become effective 10 days from the date of its issuance.

The provisions of this ORDER shall be binding upon the Bank and its institution-affiliated parties, successors and assigns.

The provisions of this ORDER shall remain effective and enforceable except to the extent that, and until such time as, any provisions of this ORDER shall have been modified, terminated, suspended, or set aside by the FDIC.

Pursuant to delegated authority.

Dated this 12th day of December, 1990.