

[{{11-30-02 p.C-5132}}](#)

[¶11,794] **In the Matter of Citizens State Bank of Clara City, Clara City, Minnesota**, Docket No. 00-127b (5-9-01).

A cease and desist order was issued, based on findings by the FDIC that it had reason to believe that respondent had engaged in unsafe and unsound practices. (*This order was terminated by order of the FDIC dated 9-30-02; see ¶16,319.*)

[.1] **Management—Management Plan Required**

[.2] **Board of Directors—Outside Directors Added to Board** %.2
[{{7-31-01 p.C-5133}}](#)

[.3] **Loan Policy—Preparation or Revision of Policy Required**

[.4] **Bank Operations—Policy Review and Revision Required**

[.5] **Conflicts of Interest—Written Policy Required**

[.6] **Board of Directors—Motor Vehicle Policy Required**

[.7] **Assets—Charge-off or Collection**

[.8] **Loans—Risk Position—Reduction of Adversely Classified Lines of Credit Required**

[.9] **Loans—Extensions of Credit—To Borrowers with Existing Adversely Classified Credits**

[.10] **Loans—Interest—Accrual of**

[.11] **Board of Directors—Internal Review and Grading System**

[.12] **Loans—Special Mention**

[.13] **Loan Loss Reserve—Establishment of or Increase Required**

[.14] **Violations of Law—Correction of Violations Required**

[.15] **Dividends—Dividends Restricted**

[.16] **Shareholders—Disclosure of Cease and Desist Order Required**

**In the Matter of
CITIZENS STATE BANK OF CLARA CITY
CLARA CITY, MINNESOTA
(Insured State Nonmember Bank)
ORDER TO CEASE AND DESIST**

FDIC-00-127b

Citizens State Bank of Clara City, Clara City, Minnesota ("Bank"), having been advised of its right to a Notice of Charges and of Hearing detailing the unsafe or unsound banking practices and violations of law and regulations alleged to have been committed by the Bank and of its right to a hearing on such charges under section 8(b) of the Federal Deposit Insurance Act ("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 April 20, 2001, whereby solely for the purpose of this proceeding and without admitting or denying any unsafe or unsound banking practices or violations of law or regulations, 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 and had violated laws and regulations. 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 and violations of law and regulations:

- A. failing to provide adequate supervision and direction over the affairs of the Bank to prevent unsafe or unsound practices and violations of law and regulations;
- B. engaging in management policies and practices which are detrimental to the Bank;
- C. failing to adhere to Bank policies;
- D. operating without a conflicts of interest policy;
- E. operating with an excessive volume of adversely classified assets;
- F. engaging in hazardous lending and lax collection practices, including, but not limited to, maintaining an excessive volume of adversely classified loans, extending credit which is inadequately secured, repeatedly renewing and extending carryover operating loans, maintaining an excessive volume of overdue loans that are accruing interest, failing to establish formal [{{7-31-01 p.C-5134}}](#) workout plans for problem borrowers, and failing to enforce repayment plans;
- G. operating with inadequate credit administration policies and procedures to properly identify credit risk and loss;
- H. operating with inadequate staff in the lending and audit areas;
- I. operating with deficient or inadequate loan documentation, including but not limited to current financial statement and cash flow and/or operating information;
- J. operating with an inadequate allowance for loan and lease losses for the kind and quality of assets held;
- K. overstating operating income due to the Bank's failure to properly recognize loan and lease loss;
- L. engaging in practices which produce inadequate operating income and excessive loan losses; and
- M. engaging in violations of applicable laws and regulations.

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

MANAGEMENT

[.1]1. (a) No more than 60 days from the effective date of this ORDER, the board of directors shall 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, 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;

(iv) development of formal job descriptions for each officer position; and

(v) development of a plan of action to recruit and hire any additional or replacement personnel, particularly in the lending and auditing areas, 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(a)(i) and 1(a)(iii) of this ORDER.

(b) The written management plan and any subsequent modification thereto shall be submitted to the Regional Director for review. 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 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 any subsequent modification.

BOARD OF DIRECTORS

[.2]2. (a) No more than 90 days from the effective date of this ORDER, the board of directors shall prepare and forward to the management of the Bank's holding company a list of potential candidates for nomination of the Bank's board of directors. The list shall be composed of candidates who have agreed to serve on the board of directors of the Bank and who are independent with respect to the Bank. The actions taken in identifying candidates, including any communication with such individuals, shall be documented and made a part of the minutes of the board of directors of the Bank. Copies of these minutes shall be provided to the Regional Director no more than 120 days from the effective date of this ORDER.

(b) At the next meeting of shareholders of the Bank at which directors are elected, but no more than 180 days from the effective date of this ORDER, and at each subsequent meeting of the shareholders at which directors are elected, the members of the board of directors shall, to the extent allowed by the bylaws of the Bank, nominate and support the election of candidates to the board of directors in such number that the board of directors shall include at least two members who are independent with respect to the Bank.

(c) It is the intent of this provision of this ORDER that the Bank and its institution-affiliated [{{7-31-01 p.C-5135}}](#)

parties, including the individual members of the board of directors, take all reasonable actions permitted by state law and the bylaws of the Bank to cause the board of directors of the Bank to include two (2) independent directors within 180 days from the effective date of this ORDER. The addition of independent directors to the board of directors may be accomplished by means of appointment or by election at a regular or special meeting of the Bank's shareholders, or any other means permitted by state law and the bylaws of the Bank.

(d) For purposes of this ORDER, an individual who is "independent with respect to the Bank" shall be any individual who:

(i) is not an officer of the Bank or an officer or director of any of its affiliated organizations;

(ii) does not own, directly or indirectly, more than 5 percent of the outstanding voting stock of the Bank, any subsidiary of the Bank, or any of the Bank's affiliated organizations;

(iii) is not related by blood, marriage or common financial interest to any individual who is not independent with respect to the Bank because such individual does not satisfy the criteria described in this paragraph concerning independence. The phrase "common financial interest" means any relationship involving individuals who, directly or indirectly, (1) have an ownership interest in a common enterprise, or (2) are in a debtor/creditor relationship. "Common financial interest" does not include common ownership of publicly traded securities registered with the Securities and Exchange Commission, *unless* the individuals involved have filed or are required to file a statement under 15 U.S.C. §78p; and

(iv) is not indebted to the Bank, directly or indirectly (including any "related interest" of the individual, as defined in 12 C.F.R. §215.2(n), and any member of the individual's "immediate family," as defined in 12 C.F.R. §215.2(g)), in an amount exceeding 5 percent of the Bank's Tier 1 capital and allowance for loan and lease losses.

LENDING POLICIES

[.3]3. No more than 60 days from the effective date of this ORDER, the board of directors shall review the Bank's written loan policies to ensure that such policies provide effective guidance and control of the Bank's lending function including but not limited to credit administration. Such review shall include specific consideration of the underwriting and credit administration practices noted on pages 23 to 27 of the FDIC's Report of Examination of the Bank dated October 2, 2000. The results of such review shall be recorded in the minutes of the board of directors. Thereafter, the Bank shall adhere to the written guidelines in the policies when originating, modifying, extending, or renewing any loan.

ADHERENCE TO BANK POLICIES

[.4]4. (a) No more than 60 days from the effective date of this ORDER, the board of directors shall develop written procedures whereby compliance with Bank policies is monitored and the responsibility for approving exceptions thereto is assigned.

(b) The written procedures and any subsequent modifications 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 procedures and/or subsequent modifications 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 procedures and/or subsequent modifications thereto.

CONFLICTS OF INTEREST POLICY

[.5]5. No more than 60 days from the effective date of this Order, the board of directors shall develop a comprehensive conflicts of interest policy. At a minimum, the policy shall: 1) set forth the conditions under which the Bank may extend credit, including renewals of existing credit, to borrowers who have received or will receive a loan or other extension of credit from an affiliate or institution-affiliated party of the Bank, which has been or will be used to pay the principal or interest of indebtedness owned to the Bank, and 2) include a requirement that the board of directors consider and approve, in advance, any extension of credit, including renewals of existing credit to borrowers who have outstanding any indebtedness to an affiliate or institution-affiliate party of the Bank. The policy and any subsequent
[{{7-31-01 p.C-5136}}](#)

modifications thereto shall be submitted to the Regional Director for review and comment. No more than 30 days after receipt of any comment from the Regional Director, and after consideration of such comment, the board of directors shall adopt and implement the policy, which shall be recorded in the minutes of the board of directors. Thereafter, the Bank and its institution-affiliated parties shall follow the policy and subsequent modifications thereto.

MOTOR VEHICLE POLICY

[.6]6. No more than 60 days from the effective date of this ORDER, the board of directors shall develop a written policy to govern the use of the Bank's motor vehicles. The motor vehicle policy and any subsequent modifications thereto shall be submitted to the Regional Director, and after consideration of such comment, the board of directors shall adopt and implement the written motor vehicle policy which shall be recorded in the minutes of the board of directors. Thereafter, the Bank and its institution-affiliated parties shall follow the written motor vehicle policy and subsequent modifications thereto.

CHARGE-OFF (LOSS)

[.7]7. No more than 10 days from the effective date of this ORDER, the Bank: (a) shall eliminate from its records, by charge-off, collection, or other proper entries, all assets or portions of assets classified "Loss" in the FDIC's Report of Examination of the Bank dated October 2, 2000, 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, directly or indirectly, by the Bank does not constitute collection for the purpose of this paragraph.

REDUCTION OF SUBSTANDARD LOANS

[.8]8. (a) No more than 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 \$100,000 or more which was classified "Substandard" in the FDIC's Report of Examination of the Bank dated October 2, 2000. 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" classifications within 6 and 12 months from the effective date of this ORDER; and (B) provide for the submission of written quarterly 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 8(a) and any subsequent modification thereto shall be submitted to the Regional Director for review. No more than 30 days after the receipt of any comment from the Regional Director, and after consideration of such comment, 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 modifications.

LENDING TO BORROWERS WITH ADVERSELY CLASSIFIED LOANS

[.9]9. (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," 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 7 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

[{{7-31-01 p.C-5137}}](#)

from renewing any credit already extended to the borrower.

(b) The Bank shall not extend credit, including renewals and extensions thereof, to a 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," or "Substandard," and is uncollected, who has or will receive a loan or other extension of credit from an institution-affiliated party or affiliate of the Bank to pay the accrued interest on said loan or other extension of credit unless there is full disclosure, in writing, to the Bank and a majority of the Bank's board of directors: (i) determines that such loan or other extension of credit is in the best interest of the Bank, (ii) determines that such loan or other extension of credit complies with the requirements set out in paragraph 7; and (iii) approves such loan or other extension of credit. A written record of the board of directors' determination and approval shall be maintained in the credit file of the affected borrower(s) as well as the minutes of the board of directors' meetings.

ACCRUAL OF INTEREST ON DELINQUENT LOANS

[.10]10. Effective the date of this ORDER, the Bank shall not accrue interest on any loan that is, or becomes, 90 days or more delinquent as to principal or interest, unless the loan is both well secured and in the process of collection; "well secured" and "in the process of collection" shall have the same meaning as those terms have in the prevailing Instructions for Preparation of Reports of Condition and Income ("Instructions"). The Bank shall reverse on its books all previously accrued but uncollected interest on any loan that has ceased to accrue interest pursuant to this provision.

INTERNAL LOAN REVIEW

[.11]11. No more than 60 days from the effective date of this ORDER, the board of directors shall adopt and implement a loan review process and internal grading system that identifies credit risk in: 1) individual loans of \$100,000 or more, and 2) extensions of credit where the aggregate amount of credit extended to a borrower and/or the borrower's related interests is \$100,000 or more. For purposes of this ORDER, "extension of credit" has the same meaning as provided in section 215.3(a) of Regulation O of the Board of Governors of the Federal Reserve System ("Regulation O"), 12 C.F.R. §215.3(a). For purposes of this ORDER, the term "related interest" has the same meaning as provided in section 215.2(n) of Regulation O, 12 C.F.R. §215.2(n). Such loan review process and internal grading system shall address the concerns noted on page 26 of the FDIC's Report of Examination of the Bank dated October 2, 2000. The loan review shall focus on the strength of each individual loan instead of the general credit worthiness of each borrower. The process shall include, at a minimum: (a) review of individual loans independent of the loan officer responsible for the day-to-day servicing of such loan, (b) risk reporting to the Bank's board of directors on a monthly basis, and (c) policies and procedures for identifying and reporting loans which warrant individual review and consideration by the Bank's board of directors. The loan review process and internal grading system and any subsequent modifications thereto, and the approval thereof, shall be recorded in the minutes of the board of directors. Thereafter, the Bank and its institution-affiliated parties shall follow such loan review process and internal grading system and subsequent modifications thereto.

CORRECTION OF DOCUMENTATION EXCEPTIONS AND SPECIAL MENTION WEAKNESSES

[.12]12. (a) No more than 60 days from the effective date of this ORDER, the Bank shall **use** its best efforts to correct the credit data or collateral documentation exceptions noted on pages 71 to 76 of the FDIC's Report of Examination of the Bank dated October 2, 2000. The Bank shall maintain in the appropriate borrower credit file, a written record of all action taken to correct the foregoing exceptions. For any loan for which the aforesaid correction is not accomplished, the Bank's board of directors shall maintain in its minutes, and include in the appropriate borrower credit file, a written record of all action taken by the Bank to correct such exceptions.

(b) No more than 60 days from the effective date of this ORDER, the Bank shall correct the cited weaknesses and deficiencies in the loans listed for "Special Mention" on pages 67-69 of the FDIC's Report of Examination of the Bank dated October 2, 2000.

[{{7-31-01 p.C-5138}}](#)

ALLOWANCE FOR LOAN AND LEASE LOSSES

[.13]13. (a) As used in this ORDER, "allowance for loan and lease losses" ("allowance") means the same as the term in section 325.2(a) of the FDIC Rules and Regulations, 12 C.F.R. §325.2(a), and in the Instructions.

(b) The Bank shall have and maintain an adequate allowance in accordance with the requirements of the Instructions.

(c) 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 September 30, 2000, and the effective date of this Order, shall, at a minimum, reflect an allowance 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.

(d) Prior to the submission of any Report of Condition and 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, (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 or decreases in the allowance, and the basis for determining the amount of allowance provided.

VIOLATIONS OF LAW

[.14]14. No more than 60 days from the effective date of this ORDER, the Bank shall eliminate and/or correct all violations of law and regulations committed by the Bank as described on pages 35 to 37 of the

FDIC's Report of Examination of the Bank dated October 2, 2000. Thereafter, the Bank shall implement review procedures to prevent future violations.

DIVIDENDS

[.15]15. The Bank shall not declare or pay any cash dividends unless:

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

(b) After payment of such dividends, the ratio of adjusted Tier 1 capital to adjusted Part 325 total assets of the Bank will be not less than six (6.0) percent.

SHAREHOLDER NOTICE

[.16]16. Following the effective date of this ORDER, the Bank shall send to its shareholder 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 Section, 550 17th Street, N.W. (F-6043), Washington, D.C. 20429-9990, for review at least 20 days prior to dissemination of the description, communication, notice, or statement.

PROGRESS REPORTS

17. The Bank shall furnish written progress reports to the Regional Director and the Minnesota Commissioner of Commerce ("Commissioner"), detailing the form and manner of any action taken to secure compliance with this ORDER and the results thereof every 90 days, or more frequently if requested by the Regional Director or the Commissioner, beginning 90 days from the effective date of this ORDER. 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.

DEFINITIONS

18. All technical words or terms used in this ORDER, for which meanings are not specified or otherwise provided for by the provisions of this ORDER, shall, insofar as applicable, have meanings as defined in Chapter 3 of Title 12 of the *Code of Federal Regulations* or the Act, as such definitions may be amended after the execution of this ORDER, and any such technical words or terms used in this ORDER and undefined in said *Code of Federal Regulations* of the Act shall have meanings that accord with their best custom and usage in the banking industry.

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

The provisions of this ORDER shall be

[{{7-31-01 p.C-5139}}](#)

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 9th day of May, 2001.