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{{2-28-02 p.C-4817}}

[¶11,664] **In the Matter of First Farmers & Merchants State Bank of Grand Meadow, Grand Meadow, Minnesota, Docket No. 99-001b (10-28-99)**

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 12-19-01; see ¶16,297.)*

- [.1] **Management—Qualifications Specified**
- [.2] **Board of Directors—Supervision of Bank Affairs, Written Plan**
- [.3] **Board of Directors—Meetings—Frequency of Meetings Specified**
- [.4] **Assets—Tier 1 Capital**
- [.5] **Loan Loss Reserve—Establishment of or Increase in Required**
- [.6] **Reports of Condition and Income—Complete in Accordance with Instructions**
- [.7] **Loans—Concentration of Credit—Risk Segmentation Analysis Required**

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- [.8] **Loans—Extension of Credit—To Borrowers with Existing Adversely Classified Credits**
- [.9] **Profit Plan—Preparation of Plan Required**
- [.10] **Funds Management and Liquidity—Preparation or Revision of Funds Management Policy Required**
- [.11] **Investments and Investment Policy—Investment Policy, Preparation or Revision Required**
- [.12] **Technical Exceptions—Correction of Technical Exceptions Required**
- [.13] **Violations of Law—Correction of Violations Required**
- [.14] **Bank Operations—Internal Routine and Control Procedures—Establish**
- [.15] **Brokered Deposits—Notification Required**
- [.16] **Shareholders—Disclosure of Cease and Desist Order Required**

In the Matter of

**FIRST FARMERS & MERCHANTS
STATE BANK OF GRAND MEADOW
GRAND MEADOW, MINNESOTA
(Insured State Nonmember Bank)
ORDER TO CEASE AND DESIST
FDIC-99-001b**

The Federal Deposit Insurance Corporation ("FDIC") on April 29, 1999, issued to First Farmers & Merchants State Bank of Grand Meadow, Grand Meadow, Minnesota ("Bank") a NOTICE OF CHARGES AND OF HEARING ("NOTICE") under section 8(b) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. §1818(b). The NOTICE charged the Bank with having engaged in unsafe or unsound banking practices and having violated certain laws and/or regulations.

The Bank and counsel for the FDIC thereafter executed a STIPULATION AND CONSENT TO THE ISSUANCE OF AN ORDER TO CEASE AND DESIST ("CONSENT AGREEMENT") dated October 20, 1999, whereby solely for the purpose of this proceeding and without admitting or denying any of the allegations in the NOTICE, 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/or 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/or regulations:

- A. operating with an excessive volume of adversely classified assets;
- B. engaging in hazardous lending and lax collection practices, including, but not limited to, maintaining an excessive volume of adversely classified loans, maintaining an excessive volume

- of overdue loans, extending credit which is inadequately secured, maintaining undue concentrations of credit, and extending credit with inadequate diversification of risk;
- C. engaging in violations of applicable laws and regulations;
- D. operating with management whose policies and practices are detrimental to the Bank;
- E. operating with deficient or inadequate loan documentation;
- F. engaging in practices which produce inadequate operating income and excessive loan losses;
- G. failing to provide adequate supervision and direction over the affairs of the Bank to prevent unsafe or unsound practices and violations of law and/or regulations;
- H. operating with an inadequate allowance for loan and lease losses for the volume, kind and quality of loans held; and
- I. operating with inadequate internal controls.

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

[.1]1. (a) No more than 90 days from the effective date of this ORDER, the Bank shall have and retain qualified management. At a minimum, such management shall include a president with proven ability in managing a bank of comparable size and experience in upgrading a low quality loan portfolio, and an experienced senior lending officer. Such president shall be provided the necessary written authority to implement the provisions of this ORDER. The qualifications of management shall be assessed on its ability to:

- (i) comply with the requirements of this ORDER;
- (ii) operate the Bank in a safe and sound manner;
- (iii) comply with applicable laws and regulations; and
- (iv) restore all aspects of the Bank to a safe and sound condition, including asset quality, capital adequacy, earnings, management effectiveness, and liquidity. During the life of this ORDER, the Bank shall notify the Regional Director of the FDIC's Kansas City Regional Office ("Regional Director") in writing of any changes in management. The notification must include the names and background of any replacement personnel and must be provided prior to the individual assuming the new position.

(b) To facilitate having and retaining qualified management, 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 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 Bank's 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.

[.2](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.

(d) (i) The written management plan shall also include the requirement that the board of directors of the Bank, or a committee thereof consisting of not less than three 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.

(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 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.

(iii) For purposes of this ORDER, an individual who is "independent with respect to the Bank" shall be any individual who: (A) is not an officer or employee of the Bank or any of the Bank's affiliated organizations; (B) does not own more than 5 percent of the outstanding shares of the Bank or any of the Bank's affiliated organizations; (C) is not related by [12-31-99 p.C-4820](#) blood, marriage or common financial interest to an officer or employee of the Bank or any of the Bank's affiliated organizations or to any stockholder owning more than 5 percent of the outstanding shares of the Bank or any of the Bank's affiliated organizations, and (D) is not indebted to the Bank, directly or indirectly (including indebtedness of any entity in which the individual has a substantial financial interest), in an amount exceeding 5 percent of the Bank's Tier 1 capital and allowance for loan and lease losses as defined in paragraphs 2(a)(i) and 3(a) of this ORDER.

[.3](e) Effective the date of this ORDER, the Bank's board of directors shall meet at least monthly. The board shall prepare in advance and shall follow a detailed written agenda at each 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.

[.4]2. (a) As used in this ORDER:

- (i) "Tier 1 or core capital" ("Tier 1 capital") means the same as the term in section 325.2(t) of the FDIC's Rules and Regulations, 12 C.F.R. §325.2(t).
- (ii) "Noncumulative perpetual preferred stock" means the same as the term in section 325.2(o) of the FDIC's Rules and Regulations, 12 C.F.R. §325.2(o).
- (iii) "Total assets" means the same as the term in section 325.2(v) of the FDIC's Rules and Regulations, 12 C.F.R. §325.2(v).
- (iv) "Securities" means common and noncumulative perpetual preferred stock.

[.5](b) 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's Rules and Regulations, 12 C.F.R. §325.2(a), and in the Instructions for Preparation of Reports of Condition and Income ("Instructions").

(c) After appropriate entries for an adequate allowance are made in accordance with the requirements of paragraph 3 of this ORDER, the Bank shall have as of each Report date, as that term is used in the Instructions (i.e. March 31, June 30, September 30, and December 31). Tier 1 capital at or in excess of 8 percent of the Bank's total assets ("Tier 1 leverage capital ratio"). From and after March 31, 1999, for purposes of calculating the Tier 1 leverage capital ratio, Tier 1 capital and total assets shall be the dollar amount reported in the Bank's most recent Report of Condition and Income.

(d) During the period this ORDER is in effect, if the Tier 1 leverage capital ratio declines below 8 percent as of any Report date, the Bank shall, within 60 days after the Report date on which the said ratio so declined, submit a written plan to the Regional Director for approval describing the means and timing by which the Bank shall increase such ratio up to or in excess of 8 percent. Upon receiving written notification of the approval of the plan, the Bank shall increase its Tier 1 leverage capital ratio to equal or exceed 8 percent in accordance with the approved plan and this ORDER.

(e) 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 2(c)-2(d) of this ORDER.

[.6]3. (a) The Bank shall have and maintain an adequate allowance in accordance with the requirements of the Instructions.

(b) Reports of Condition and Income required to be submitted by the Bank as of each Report date, between and including September 30, 1998, 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.

(c) 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 in the allowance, and the basis for determining the amount of allowance provided.

[.7]4. (a) Within 30 days from the effective date of this ORDER, the board of directors shall develop a written plan of action ~~{{12-31-99 p.C-4821}}~~ to lessen the Bank's risk position in each line of credit aggregating \$50,000 or more which was classified "Substandard" as of June 30, 1998. 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 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 4(a) and any subsequent modification thereto shall be submitted to the Regional Director 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 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 plan of action and/or any subsequent modification thereto.

[.8]5. (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 (or for charged off or classified loans that are \$10,000 or less, a majority of the Bank's loan committee) first (a) determines that such advance is in the best interest of the Bank, and (b) 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.

(b) No more than 90 days from the effective date of this ORDER, the Bank shall review the Bank's written loan policies and shall record the results of such review in the board of directors' minutes. Thereafter, the Bank and its institution-affiliated parties shall follow the written loan policies.

[.9]6. (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:

- (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 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/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 profit plan and/or any subsequent modification thereto.

[.10]7. (a) No more than 30 days from the effective date of this ORDER, the Bank shall develop a written funds management policy which shall, 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 ~~{{12-31-99 p.C-4822}}~~ are generally defined as those that either mature or can be reprised 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 and investment policies and the Bank's profit plan.

(c) The written funds management policy 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, the board of directors shall approve the written funds management policy 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 funds management policy and/or any subsequent modification thereto.

[.11]8. No more than 30 days from the effective date of this ORDER, the Bank shall develop a written investment policy consisting of goals and strategies for improving the investments of the Bank. The written investment policy 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, the board of directors shall approve the written investment plan and/or any subsequent modification thereto, which approval shall be recorded in the minutes of the board. Thereafter, the Bank and its institution-affiliated parties shall follow the written investment plan and/or any subsequent modification thereto.

9. No more than 60 days from the effective date of this ORDER, the Bank shall formulate and implement a plan to reduce all concentrations of credit as noted on pages 92 through 94 of the FDIC's Report of Examination of the Bank as of June 30, 1998, to less than 25 percent of total equity capital and allowance for loan and lease losses.

[.12]10. The Bank shall correct the technical exceptions on loans noted on pages 90 and 91 of the FDIC's Report of Examination of the Bank as of June 30, 1998, except for the loans to John T./Kimberly Avant, Ronald Frazer, Edwin Irlbeck, Charles V. Kerrins and Stier-Avant Motors, Inc., for which the Bank shall take all steps possible to correct the technical exceptions.

[.13]11. The Bank shall eliminate and/or correct the violations of law and regulations committed by the Bank as described on pages 49 through 53 of the FDIC's Report of Examination of the Bank as of June 30, 1998. The Bank shall take all steps possible to eliminate and/or correct the violations of law and regulations described on pages 43 through 48 of the FDIC's Report of Examination of the Bank as of June 30, 1998.

[.14]12. No more than 30 days from the effective date of this ORDER, the Bank shall develop a policy for the operation of the Bank in such a manner as to provide adequate internal routines and controls consistent with safe and sound banking practices and which shall, at a minimum, address the deficiencies set forth on page 98 of the FDIC's Report of Examination of the Bank as of June 30, 1998. This policy (which may be combined with the Bank's 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, the board of directors shall approve the policy, and/or 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 policy and/or any subsequent modification thereto.

[.15]13. While this ORDER is in effect, the Bank shall give written notice to the Regional Director when the Bank intends to make use of brokered deposits. The notification shall indicate how the brokered deposits are to be utilized with specific reference to credit quality of investments/loans and the effect on the Bank's funds position and asset/liability matching. The Regional Director shall have the right to reject the Bank's plans for utilizing brokered deposits. For purposes of this ORDER, brokered deposits are defined as described in section 337.6(a)(2) of the FDIC's Rules and Regulations, 12 C.F.R. §337.6(a)(2).

[.16]14. Following the effective date of this ORDER, the Bank shall send to its shareholder(s) 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 to shareholders. Any changes requested by the FDIC shall be made prior to dissemination of the description, communication, notice, or statement.

15. The Bank shall furnish written progress reports to the Regional Director and the Commissioner of Commerce for the State of Minnesota 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 of Commerce. 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.

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 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 28th day of October, 1999.