

**FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.**

In the Matter of)	
)	
THE GARY STATE BANK)	ORDER TO
GARY, MINNESOTA)	CEASE AND DESIST
)	
(Insured State Nonmember Bank))	FDIC-07-083b
)	

The Gary State Bank, Gary, Minnesota ("Bank"), having been advised of its rights to a NOTICE OF CHARGES AND OF HEARING detailing the unsafe or unsound banking practices and violations of law and regulation alleged to have been committed by the Bank, as well as of its rights to a hearing on the 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") dated May 17, 2007, with counsel for the Federal Deposit Insurance Corporation ("FDIC"), whereby, solely for the purpose of this proceeding and without admitting or denying any unsafe or unsound banking practices and violations of law and regulation, 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 and unsound banking practices and violations of law and regulation. 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 or unsound banking practices and violations of law and regulation:

- A. Operating with management whose policies and practices are detrimental to the Bank and jeopardize the safety of its deposits.
- B. Operating with a board of directors that has failed to provide adequate supervision over and direction to the management of the Bank.
- C. Operating with an inadequate level of capital protection for the kind and quality of assets held and appropriate to the risk inherent in the activities engaged in by the Bank.
- D. Operating with an inadequate allowance for loans and lease losses for the volume, kind, and quality of loans and leases held.
- E. Engaging in hazardous lending and lax collection practices, including, but not limited to:
 - 1. the failure to obtain proper loan documentation;
 - 2. the failure to obtain adequate collateral;
 - 3. the failure to establish and monitor collateral margins of secured borrowers;
 - 4. the failure to establish and enforce adequate loan repayment programs;
 - 5. the failure to obtain current and complete financial information;

6. the extension of credit with inadequate diversification of risk;
 7. the extension of credit without adequate analysis of borrower repayment capacity; and
 8. other poor credit administration practices.
- F. Operating with an excessive level of adversely classified loans or assets.
- G. Operating with an inadequate loan policy.
- H. Violating laws and regulations, including:
1. Sections 215.4(a)(1) and 215.4(b)(1) of Regulation O, 12 C.F.R. §§ 215.4(a) and 215.4(b)(1).
 2. Minn. Stat. § 48.24.
 3. Minn. Stat. § 46.07.

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

1. **Qualified Management.**

- (a) Within 180 days from the effective date of this ORDER, the Bank shall have qualified management, including a chief executive officer and an appropriate number and type of senior officers, with the requisite knowledge, skills, ability, and experience, giving consideration to the size and complexity of the Bank, to operate the Bank in a safe and sound manner, and in compliance with applicable laws and regulations, and restore the Bank to a satisfactory financial condition, including, but not limited to, capital adequacy, asset quality, management effectiveness, earnings, liquidity,

sensitivity to market risk, information technology, and Bank Secrecy Act/Anti-Money Laundering compliance. Each member of management shall be provided appropriate written authority from the Bank's board of directors to implement the provisions of this ORDER.

- (b) For purposes of this paragraph, to have "qualified management," the Bank shall add at least one senior executive officer whose responsibilities include assisting in:
 - (i) strategic planning;
 - (ii) supervision of the lending function; and
 - (iii) the Bank's compliance with the ORDER.
- (c) Immediately and periodically during the life of this ORDER, but no less frequently than annually, management shall be assessed on its ability to:
 - (i) Comply with the requirements of this ORDER, all applicable State and Federal laws and regulations, FDIC and FFIEC policy statements and the Bank's approved policies and procedures; and
 - (ii) Restore and thereafter maintain the Bank in a safe and sound condition, including, but not limited to, capital adequacy, asset quality, earnings, management effectiveness, liquidity, sensitivity to market risks, information technology, and Bank Secrecy Act/Anti-Money Laundering compliance.
- (d) Within 180 days, the Bank will adopt a management succession plan.

2. **Addition of Independent Board Members.**

- (a) Within 120 days of the effective date of this Order, the Bank shall add two new members to its board of directors, one of which shall be independent. If necessary, the Bank shall cause its articles of incorporation or by-laws or other governing corporate instrument to be amended to reflect the action required by this paragraph. The Bank shall document each action initiated by the Bank to achieve compliance with this paragraph. Such documentation shall be submitted to the Bank's board of directors for review and approval, and then maintained at the Bank. If the requirements of this paragraph are not satisfied within the 120 day timeline, the Bank shall continue to document its efforts to achieve compliance.
- (b) An independent director shall be any individual who:
- (i) is not an officer, director or employed in any capacity by the Bank, or any subsidiary;
 - (ii) does not own or control more than 5 percent of the outstanding shares of the Bank;
 - (iii) is not related within 2 degrees of consanguinity, or married to such a relative, of an officer or director of the Bank or any Bank subsidiary, or to any shareholder owning more than 5 percent of the outstanding shares of the Bank;
 - (iv) who does not otherwise share a common financial interest with any officer, director or shareholder, other than possible ownership in publicly-traded securities; or,

- (v) is otherwise deemed to be an independent director for purposes of this ORDER by the Regional Director and the Commissioner.

3. **Changes in Board of Directors and/or Senior Officers.**

During the life of this ORDER, the Bank shall notify the Regional Director and the Deputy Commissioner of the State of Minnesota Department of Commerce ("Deputy Commissioner") in writing of any resignations and/or terminations of any members of its board of directors and/or any of its senior officer(s) within 15 days of the event. The Bank shall also establish procedures to ensure compliance with section 32 of the FDI Act, 12 U.S.C. § 1831i and Subpart F of Part 303 of the FDIC's Rules and Regulations, 12 C.F.R. §§ 303.100 through 303.103. In addition, the Bank shall notify the Regional Director and the Deputy Commissioner in writing when it proposes to add any individual to the Bank's board of directors or employ any individual as a senior executive officer. The notification must be received at least 30 days before such addition or employment is intended to become effective and should include a description of the background and experience of the individual(s) to be added or employed.

4. **Minimum Capital Requirements.**

(a) The Bank shall maintain the following minimum capital levels (as defined in Part 325 of the FDIC's Rules and Regulations), after establishing an adequate allowance for loan and lease losses:

- (i) Tier 1 capital at least equal to 8 percent of total assets;

- (ii) Tier 1 risk-based capital at least equal to 6 percent of total risk-weighted assets; and
 - (iii) Total risk-based capital at least equal to 10 percent of total risk-weighted assets.
- (b) In addition, the Bank shall comply with the FDIC's Statement of Policy on Risk-Based Capital found in Appendix A to part 325 of the FDIC Rules and Regulations, 12 C.F.R. Part 325, App. A.
- (c) In the event any capital ratio prescribed in this part falls below the established minimum, the Bank shall notify the Regional Director and the Deputy Commissioner and shall within 30 days, increase capital in an amount sufficient to comply with this provision or submit a capital plan within 90 days to achieve compliance.

5. Dividend Restriction.

While this ORDER is in effect, the Bank shall not declare or pay any cash dividends without the prior written approval of the Regional Director and the Deputy Commissioner.

6. Charge-off of Adversely Classified Assets.

- (a) Within 30 days from the effective date of this ORDER, the Bank shall eliminate from its books, by charge-off or collection, all assets or portions of assets classified "Loss" in the FDIC and State's Report of Examination dated January 29, 2007 ("Report of Examination") that have not been previously collected or charged off.

- (b) Elimination or reduction of assets through proceeds of other loans made by the Bank is not considered collection for purposes of this provision.

7. Maintenance of Allowance for Loan and Lease Losses.

- (a) Within 30 days from the date of this ORDER, the board of directors shall make a provision of at least \$175,000 to replenish the allowance for loan and lease losses (allowance) for the loans charged off as a result of the most recent examination and reflect the potential for further losses in the remaining loans or leases classified "Substandard" in the Report of Examination as well as all other loans and leases in its portfolio.
- (b) Within 90 days from the effective date of this ORDER, the board shall establish a comprehensive policy and methodology for determining the appropriateness of the allowance. The policy shall provide for a review of the allowance at least once each calendar quarter and be completed at least 30 days prior to the end of each quarter in order that the results of the review conducted by the Board may be properly reported in the quarterly Reports of Condition and Income. Such reviews shall, at a minimum, include the following:
- (i) the Federal Financial Institutions Examination Council's Instructions for the Reports of Condition and Income, the Interagency Statement of Policy on the Allowance for Loan and Lease Losses, other applicable regulatory guidance that addresses the appropriateness of the Bank's

allowance, and any analysis of the Bank's allowance provided by the FDIC and the Deputy Commissioner;

- (ii) the volume and mix of the overall loan portfolio, including trends in the portfolio mix by loan type and geography, trends in the severity of nonperforming or delinquent loans, trends in the severity of weaknesses in extensions of credit identified as "Special Mention" and adversely classified in the latest Report of Examination;
- (iii) previous loan loss experience by loan type, including the level, trends, and severity of overdrafts, trend of net charge-offs as a percent of average loans over the past several years, as well as an analysis of net charge-offs experienced on previously adversely classified loans;
- (iv) the degree of risk associated with renewed and extended loans;
- (v) the volume, trend, rate and duration of loan growth;
- (vi) the results of internal loan reviews;
- (vii) concentrations of credit and significant individual credits;
- (viii) present and prospective economic conditions, generally and locally;
- (ix) off-balance sheet credit risks; and
- (x) any other factors appropriate in determining future allowances, including changes in the

Bank's strategic plan, and loan products and markets.

- (c) A deficiency in the allowance shall be remedied in the calendar quarter in which it is discovered by a charge to current operating earnings prior to any Tier 1 capital determinations required by this ORDER and prior to the Bank's submission of its Report of Condition and Report of Income. The board shall thereafter maintain an adequate allowance.
- (d) The Bank shall submit the policy to the Regional Director and the Deputy Commissioner for review and comment. Within 30 days from receipt of any comment from the Regional Director and the Deputy Commissioner, and after due consideration of any recommended changes, the Bank shall approve the policy, which approval shall be recorded in the minutes of the board of directors meeting. Thereafter, the Bank shall implement and fully comply with the policy.

8. Reduction of Adversely Classified Assets.

- (a) Within 60 days from the effective date of this ORDER, the Bank shall develop and submit to the Regional Director and Deputy Commissioner a written plan to reduce the Bank's risk exposure in each asset in excess of \$25,000 classified "Substandard" or "Doubtful" in the Report of Examination. For purposes of this provision, "reduce" means to collect, charge off, or improve the quality of an asset so as to warrant its removal from adverse classification by the

FDIC and the Deputy Commissioner. In developing the plan mandated by this paragraph, the Bank shall, at a minimum, and with respect to each adversely classified loan or lease, review, analyze and document the financial position of the borrower, including source of repayment, repayment ability and alternative repayment sources, as well as the value and accessibility of any pledged or assigned collateral, and any possible actions to improve the Bank's collateral position.

- (b) The Bank shall submit the plan to the Regional Director and the Deputy Commissioner for review and comment. Within 30 days from receipt of any comment from the Regional Director and the Deputy Commissioner, and after due consideration of any recommended changes, the Bank shall approve the plan, which approval shall be recorded in the minutes of the meeting of the board of directors. Thereafter, the Bank shall implement and fully comply with the plan.

9. Restrictions on Advances to Adversely Classified Borrowers.

- (a) While this ORDER is in effect, the Bank shall not extend, directly or indirectly, any additional credit to, or for the benefit of, any borrower who has a loan or other extension of credit or obligation with the Bank that has been, in whole or in part, charged off or classified "Substandard," "Doubtful," or "Loss" in the Report of Examination and is uncollected. The requirements of this paragraph shall not prohibit the Bank from renewing, after collecting in cash all

interest and fees due from a borrower, any credit already extended to the borrower.

(b) Paragraph 9(a) shall not apply if the Bank's failure to extend further credit to a particular borrower would be detrimental to the best interests of the institution and the Bank's board of directors approves the loan and supports its action in the board minutes. Prior to extending additional credit pursuant to this paragraph, whether in the form of a renewal, extension, or further advance of funds, the board of directors must conclude and fully document in its written minutes that:

- (i) the failure of the Bank to extend such credit would be detrimental to the best interests of the Bank, with an explanation of why it would be detrimental;
- (ii) the extension of such credit would improve the Bank's position, with an explanation of why the Bank's position would improve; and
- (iii) an appropriate workout plan has been developed and will be implemented in conjunction with the additional credit to be extended.

(c) The board of directors' conclusions and loan approval shall be made a part of the minutes of the board meeting, with a copy retained in the borrower's credit file.

10. Correction of Technical Exceptions.

(a) Within 90 days from the effective date of this ORDER, the Bank shall correct the exceptions listed on the

"Assets with Credit Data or Collateral Documentation Exceptions" pages of the Report of Examination. For any exception that cannot be corrected, the Bank shall document the reasons for such failure in the borrowers' credit file, and the board of directors shall review and include the documentation in the board minutes.

- (b) The Bank shall ensure that all necessary supporting documentation is obtained and evaluated before any credit or loan is extended.

11. Reduction of Special Mention Assets.

Within 60 days from the effective date of this ORDER, the Bank shall develop a plan to correct the deficiencies in the assets listed for "Special Mention" in the Report of Examination. The Bank shall immediately submit the plan to the Regional Director and the Deputy Commissioner for review and comment. Within 30 days from receipt of any comment from the Regional Director and the Deputy Commissioner, and after due consideration of any recommended changes, the Bank shall approve the plan, which approval shall be recorded in the minutes of the board of directors meeting. Thereafter, the Bank shall implement and fully comply with the plan.

12. Implementation of Loan Policy.

- (a) Within 90 days from the effective date of this ORDER, and annually thereafter, the board of directors of the Bank shall review the Bank's loan policies and

procedures for adequacy and, based upon this review, shall make all appropriate revisions to the policies and procedures necessary to strengthen the Bank's asset quality and lending functions and to prevent further deterioration. As required by this paragraph, the Bank's loan policies shall be enhanced to address, at a minimum, the loan policy deficiencies and recommendations listed on pages 12-13 of the Report of Examination, including but not limited to the following:

- (i) Establish review and monitoring procedures to ensure that all lending personnel are adhering to established lending procedures, and that the directorate is receiving timely and fully documented reports on loan activity, including reports that identify deviations from established policy and the loan officers responsible for the deviations;
- (ii) Require that for all extensions of credit originated or renewed by the Bank:
 - (A) have a clearly defined and stated purpose;
 - (B) have a predetermined and realistic repayment source and schedule, including secondary source of repayment;
 - (C) are supported by complete loan documentation, including lien searches, perfected security interests, and collateral valuations; and
 - (D) are supported by current financial information, profit and loss statements, or

copies of tax returns, and cash flow projections, which information shall be maintained throughout the term of the loan; and are otherwise in conformance with the Bank's lending policies and procedures.

- (iii) Establish standards for extending unsecured credit;
 - (iv) Address concentrations of credit and diversification of risk, including goals for portfolio mix, establishment of limits within loan and other asset categories, and development of a tracking and monitoring system for the economic and financial condition of specific geographic locations, industries, and groups of borrowers;
 - (v) Require the establishment and maintenance of an appropriate loan grading system and internal loan watch list; and
 - (vi) Require a written plan to lessen the risk position in each line of credit identified as a problem credit on the Bank's internal loan watch list.
- (b) The Bank shall submit the revised policy to the Regional Director and the Deputy Commissioner for review and comment. Within 30 days from receipt of any comment from the Regional Director and the Deputy Commissioner, and after due consideration of any recommended changes, the Bank shall approve the policy, with its approval recorded in the minutes of

the board of directors meeting. Thereafter, the Bank shall implement and fully comply with the policy.

13. Profit and Budget Plan.

Within 120 days from the effective date of this ORDER, and within the first 30 days of each calendar year thereafter, the board of directors shall develop and fully implement a written profit plan consisting of goals and strategies, consistent with sound banking practices, and taking into account the Bank's other written plans, policies, or other actions as required by this Order. The profit plan and any subsequent modification thereto shall be submitted to the Regional Director and the Deputy Commissioner for review and comment. No more than 30 days after the receipt of any comment from the Regional Director and the Deputy Commissioner, the board of directors shall approve the profit plan which approval shall be recorded in the minutes of the meeting of the board of directors. Thereafter, the Bank shall fully implement the profit plan and any subsequently approved modification. The written profit plan shall include, at a minimum:

- (a) a description of the operating assumptions that form the basis for, and adequately support, material projected revenue and expense components;
- (b) coordination of the Bank's loan, investment, funds management, and operating policies, strategic plan, and allowance for loan and lease loss methodology with the profit and budget planning; and
- (c) a budget review process to monitor the revenue and expenses of the Bank whereby actual performance is

compared against budgetary projections not less than quarterly, recording the results of the evaluation and any actions taken by the Bank in the minutes of the board of directors meeting at which such evaluation is undertaken.

14. Ethics Policy.

- (a) Within 60 days from the effective date of this ORDER, the Bank shall develop, adopt and implement a written ethics policy ("Ethics Policy") and program ("Ethics Program") designed to bring to the attention of each member of the board conflicts of interest which may exist in approving loans or other transactions in which officers, directors or principal stockholders of the Bank ("Insiders") are involved. The Ethics Policy will state the ethical conduct and other standards expected of directors, officers, employees, agents and other persons participating in the conduct of the affairs of the Bank ("Covered Individuals"), in the performance of their duties and responsibilities, and establish the definitions, instructions and format to be followed by Covered Individuals in the preparation of comprehensive conflict disclosure statements ("statements") to be filed for review by the board. At a minimum, the Ethics Program will prohibit self-dealing by insiders or their advancing personal, business, or other interests, or those of others, at the expense of the Bank, and require:
- (i) Initial statements from all existing Covered Individuals;

- (ii) Initial statements from any person who becomes a new Covered Individual;
 - (iii) Periodic statements from all Covered Individuals;
 - (iv) The disclosure of all potential conflicts of interest arising from a business or other interest or affiliation; and
 - (v) Immediate reporting of new conflicts or discovery of previously unreported conflicts.
- (b) The Ethics Program will, at a minimum, ensure that each member of the board has been apprised of any potential conflict prior to making a decision, and has acted specifically on any loan or other transaction in which Insiders and/or their business associates are, directly or indirectly, involved. The results of any deliberations by the board of directors regarding potential conflicts shall be reflected in the minutes of its meetings. The Ethics Program will also address the ethical and other conduct and responsibilities with respect to Covered Individuals, and specifically the permissibility and disclosure of financial interests and obligations that appear to conflict with the individual's duties and responsibilities, including, but not limited to, participation of any sort in any transaction or loan in which the individual, his spouse, child, partner, or any organization in which the individual has a financial interest, or serves as an officer, director, trustee, or a partner is involved.
- (c) The Bank shall submit the policy and program to the Regional Director and the Deputy Commissioner for review and comment. Within 30 days from the receipt

of any such comments from the Regional Director and the Deputy Commissioner and after due consideration of any recommended changes, the Bank shall approve the policy and program, which approval shall be recorded in the minutes of the meeting of the board of directors. The Bank shall thereafter implement and enforce the policy and program.

15. Elimination and/or Correction of Violations of Laws, Rules, and Regulations.

- (a) Within 90 days after the effective date of this ORDER, the Bank shall eliminate and/or correct all violations of laws, rules and regulations in the Report of Examination. In addition, within 90 days from the effective date of this ORDER, the Bank shall adopt and implement appropriate procedures to ensure future compliance with all applicable laws, rules and regulations.
- (b) Within 90 days after the effective date of this ORDER, the Bank shall eliminate and/or correct all contraventions of policy cited in the Report of Examination. In addition, within 90 days from the effective date of this ORDER, the Bank shall adopt and implement appropriate procedures to ensure future compliance with all applicable policies.
- (c) For any violation or contravention that can not be corrected, the Bank shall document the reasons for such failure, which shall be reviewed by the board of

directors at its next monthly meeting and made a part of its minutes.

16. Reports of Condition and Income.

- (a) Within 30 days from the effective date of this ORDER, the Bank shall review all Consolidated Reports of Condition and Income filed with the FDIC on and after March 31, 2007, and shall amend and file with the FDIC amended Consolidated Reports of Condition and Income, in accordance with the Reports of Condition and Income Instructions, which accurately reflect the financial condition of the Bank as of the date of each such Report. Amended Reports of Condition and Income are to be filed if previously submitted reports contain significant errors as dictated by the Instructions for Preparation of Consolidated Reports of Condition and Income.
- (b) In addition and during the life of this ORDER, the Bank shall file with the FDIC Consolidated Reports of Condition and Income that accurately reflect the financial condition of the Bank as of the reporting period. In particular, such Reports shall incorporate any adjustment in the Bank's books made necessary or appropriate as a consequence of any State or FDIC examination of the Bank during that reporting period, to include:
 - (i) provision for loan losses and an allowance for loan and lease losses which are adequate considering the condition of the Bank's loan portfolio;

- (ii) the elimination from the Bank's books of any asset in compliance with this ORDER; and
 - (iii) other restatements as detailed in the State or FDIC examination of the Bank, or as required under this ORDER.
- (c) Further, and during the life of this ORDER, the accuracy of the Reports of Condition and Income shall be attested to by at least two directors of the Bank, other than the officer signing the officer declaration on the cover (signature) page. The Bank remains responsible for the accuracy of the data in its Reports of Condition and Income.

17. Correction of Information Technology Deficiencies.

Within 180 days from the effective date of this ORDER, management will correct the information technology deficiencies detailed on page 10 of the Report of Examination.

18. Program for Monitoring Bank's Compliance with Order.

Within 30 days from the effective date of this ORDER, the board of directors shall adopt and implement a program providing for monitoring of the Bank's compliance with this ORDER.

19. Disclosure of Order to Shareholders.

Following the effective date of this ORDER, the Bank shall provide to its shareholders or otherwise furnish a description of this ORDER, (i) in conjunction with the Bank's next shareholder communication, and (ii) 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, Division of Supervision and Consumer Protection, Accounting and Securities Disclosure Section, 550 17th Street, N.W., Room F-6066, 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. Progress Reports Detailing Compliance with ORDER.

- (a) Within 30 days of the end of the first quarter following the effective date of this ORDER, the Bank shall furnish written progress reports to the Regional Director and the Deputy Commissioner detailing the form, manner, and results of any actions taken to secure compliance with this ORDER. Such written progress reports shall provide cumulative detail of the Bank's progress toward achieving compliance with each provision of the ORDER, including at a minimum:
 - (i) description of the identified weaknesses and deficiencies;
 - (ii) provision(s) of the ORDER pertaining to each weakness or deficiency;
 - (iii) actions taken or in-process for addressing each deficiency;
 - (iv) results of the corrective actions taken;

- (v) the Bank's status of compliance with each provision of the ORDER; and
 - (vi) appropriate supporting documentation.
- (b) Additional progress reports will be provided upon the written request of the Regional Director or Deputy Commissioner.

The ORDER shall be effective immediately upon its issuance by the FDIC.

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

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

Issued Pursuant to Delegated Authority.

Dated: May 22, 2007

By:

Thomas J. Dujenski
Deputy Regional Director
Kansas City Regional Office