

FORMAL AGREEMENT

AGREEMENT BY AND BETWEEN  
THE PIONEER NATIONAL BANK OF DULUTH  
DULUTH, MINNESOTA  
AND  
THE OFFICE OF THE COMPTROLLER OF THE CURRENCY

The Pioneer National Bank of Duluth, Duluth, Minnesota (Bank) and the Comptroller of the Currency of the United States of America (Comptroller) wish to protect the interests of the depositors, other customers, and shareholders of the Bank, and, toward that end, wish the Bank to operate safely and soundly and in accordance with all applicable laws, rules and regulations.

The Comptroller, through his National Bank Examiner, has examined the Bank, and his findings are contained in the Report of Examination dated April 16, 2001 (ROE).

In consideration of the above premises, it is agreed, between the Bank, by and through its duly elected and acting Board of Directors (Board), and the Comptroller, through his authorized representative, that the Bank shall operate at all times in compliance with the articles of this Agreement.

ARTICLE I

(1) This Agreement shall be construed to be a "written agreement entered into with the agency" within the meaning of 12 U.S.C. § 1818(b)(1).

(2) This Agreement shall be construed to be a "written agreement between such depository institution and such agency" within the meaning of 12 U.S.C. § 1818(e)(1) and 12 U.S.C. § 1818(i)(2).

(3) This Agreement shall be construed to be a "formal written agreement" within the meaning of 12 C.F.R. § 5.51(c)(6)(ii). See 12 U.S.C. § 1831i.

(4) This Agreement shall be construed to be a "final order" within the meaning of 12 U.S.C. § 1818(u).

(5) All reports or plans which the Bank or Board has agreed to submit to the Assistant

Deputy Comptroller pursuant to this Agreement shall be forwarded to:

Assistant Deputy Comptroller Thomas J. Tott  
Minneapolis North Field Office  
920 Second Avenue South, Suite 800  
Minneapolis, Minnesota 55402

## ARTICLE II - NEW SENIOR LOAN OFFICER

(1) Within ninety (90) days, the Board shall appoint a new, capable Senior Loan Officer who shall be vested with sufficient executive authority to fulfill the duties and responsibilities of the position and ensure the safe and sound operation of the Bank.

(2) Prior to the appointment of any individual to the Senior Loan Officer or other senior executive officer position, the Board shall submit to the Assistant Deputy Comptroller the following information:

- (a) the information sought in the "Changes in Directors and Senior Executive Officers" booklet of the Comptroller's Corporate Manual, together with a legible fingerprint card for the proposed individual;
- (b) a written statement of the Board's reasons for selecting the proposed officer; and
- (c) a written description of the proposed officer's duties and responsibilities.

(3) The Assistant Deputy Comptroller shall have the power of veto over the employment of the proposed Senior Loan Officer. However, the failure to exercise such veto power shall not constitute an approval or endorsement of the proposed officer.

(4) The requirement to submit information and the prior veto provisions of this Article are based on the authority of 12 U.S.C. 1818(b) and do not require the Comptroller to complete his review and act on any such information or authority within ninety (90) days.

## ARTICLE III - CRITICIZED ASSETS

(1) The Bank shall take immediate and continuing action to protect its interest in

those assets criticized in the ROE, in any subsequent Report of Examination, by internal or external loan review, or in any list provided to management by the National Bank Examiners during any examination.

(2) Within thirty (30) days, the Board shall adopt, implement, and thereafter ensure Bank adherence to a written program designed to eliminate the basis of criticism of assets criticized in the ROE, in any subsequent Report of Examination, or by any internal or external loan review, or in any list provided to management by the National Bank Examiners during any examination as "doubtful," "substandard," or "special mention." This program shall include, at a minimum:

- (a) an identification of the expected sources of repayment;
- (b) the appraised value of supporting collateral and the position of the Bank's lien on such collateral where applicable;
- (c) an analysis of current and satisfactory credit information, including cash flow analysis where loans are to be repaid from operations; and
- (d) the proposed action to eliminate the basis of criticism and the time frame for its accomplishment.

(3) The Board, or a designated committee, shall conduct a review, on at least a quarterly basis, to determine:

- (a) the status of each criticized asset or criticized portion thereof that equals or exceeds one hundred thousand dollars (\$100,000);
- (b) management's adherence to the program adopted pursuant to this Article;
- (c) the status and effectiveness of the written program; and
- (d) the need to revise the program or take alternative action.

(4) A copy of each review shall be forwarded to the Assistant Deputy Comptroller on a quarterly basis (in a format similar to Appendix A, attached hereto).

(5) The Board shall ensure that the Bank has processes, personnel, and control systems to ensure implementation of and adherence to the program developed pursuant to this Article.

(6) The Bank may extend credit, directly or indirectly, including renewals, extensions or capitalization of accrued interest, to a borrower whose loans or other extensions of credit are criticized in the ROE, in any subsequent Report of Examination, in any internal or external loan

review, or in any list provided to management by the National Bank Examiners during any examination and whose aggregate loans or other extensions exceed one hundred thousand dollars (\$100,000) only if each of the following conditions is met:

- (a) the Board or designated committee finds that the extension of additional credit is necessary to promote the best interests of the Bank and that prior to renewing, extending or capitalizing any additional credit, a majority of the full Board (or designated committee) approves the credit extension and records, in writing, why such extension is necessary to promote the best interests of the Bank; and
- (b) a comparison to the written program adopted pursuant to paragraph two (2) of this Article shows that the Board's formal plan to collect or strengthen the criticized asset will not be compromised.

(7) A copy of the approval of the Board or of the designated committee shall be maintained in the file of the affected borrower.

#### ARTICLE IV - CREDIT AND COLLATERAL EXCEPTIONS

(1) Within thirty (30) days, the Board shall obtain current and satisfactory credit information on all loans lacking such information, including those listed in the ROE, in any subsequent Report of Examination, in any internal or external loan review, or in any listings of loans lacking such information provided to management by the National Bank Examiners at the conclusion of an examination.

(2) Within thirty (30) days, the Board shall ensure proper collateral documentation is maintained on all loans and correct each collateral exception listed in the ROE, in any subsequent Report of Examination, in any internal or external loan review, or in any listings of loans lacking such information provided to management by the National Bank Examiners at the conclusion of an examination.

(3) Effective immediately, the Bank may grant, extend, renew, alter or restructure any loan or other extension of credit only after:

- (a) documenting the specific reason or purpose for the extension of credit;

- (b) identifying the expected source of repayment in writing;
- (c) structuring the repayment terms to coincide with the expected source of repayment;
- (d) obtaining and analyzing current and satisfactory credit information, including cash flow analysis where loans are to be repaid from operations;
  - (i) Failure to obtain the information in (d) shall require a majority of the full Board (or a delegated committee thereof) to certify in writing the specific reasons why obtaining and analyzing the information in (d) would be detrimental to the best interests of the Bank.
  - (ii) A copy of the Board certification shall be maintained in the credit file of the affected borrower(s). The certification will be reviewed by this Office in subsequent examinations of the Bank; and
- (e) documenting, with adequate supporting material, the value of collateral and properly perfecting the Bank's lien on it where applicable.

#### ARTICLE V - INTERNAL LOAN REVIEW PROGRAM

(1) The Board shall within thirty (30) days employ or designate a sufficiently experienced and qualified person(s) or firm to ensure the timely and independent identification of problem loans and leases.

(2) Within thirty (30) days, the Board shall establish an effective, independent and on-going loan review system to review, at least quarterly, the Bank's loan and lease portfolios to assure the timely identification and categorization of problem credits and for the purpose of monitoring portfolio trends. The system shall require a quarterly written report to the Board after each review and shall use a loan and lease grading system consistent with the guidelines set forth in the *Rating Credit Risk* booklet, A-RCR, of the Comptroller's Handbook. At a minimum, the report shall provide for an independent reviewer's assessment of:

- (a) the monitoring system for early problem loan identification to assure the timely identification and rating of loans and leases based on lending officer submissions;

- (b) the overall quality of the loan and lease portfolios;
- (c) the identification, type, rating, and amount of problem loans and leases;
- (d) the identification and amount of delinquent loans and leases;
- (e) system for monitoring compliance with the Bank's lending policies and laws, rules, and regulations pertaining to the Bank's lending function; and
- (f) system for monitoring the adequacy of credit and collateral documentation and identification of credit and collateral exceptions.

(3) A written description of the program called for in this Article shall be forwarded to the Assistant Deputy Comptroller upon implementation.

(4) The Board shall ensure that the Bank has processes, personnel, and control systems to ensure implementation of and adherence to the program developed pursuant to this Article.

(5) The Board shall evaluate the internal loan and lease review report(s) and shall ensure that immediate, adequate, and continuing remedial action, if appropriate, is taken upon all findings noted in the report(s).

(6) A copy of the reports submitted to the Board, as well as documentation of the action taken by the Bank to collect or strengthen assets identified as problem credits, shall be preserved in the Bank.

## ARTICLE VI - ALLOWANCE FOR LOAN AND LEASE LOSSES

(1) The Board shall review the adequacy of the Bank's Allowance for Loan and Lease Losses (Allowance) and shall establish a program for the maintenance of an adequate Allowance. This review and program shall be designed in light of the comments on maintaining a proper Allowance found in the *Allowance for Loan and Lease Losses* booklet, A-ALLL, of the Comptroller's Handbook, and shall focus particular attention on the following factors:

- (a) results of the Bank's internal loan review;
- (b) results of the Bank's external loan review;
- (c) an estimate of inherent loss exposure on each significant or criticized credit;

- (d) loan loss experience;
- (e) trends of delinquent and nonaccrual loans;
- (f) concentrations of credit in the Bank;
- (g) present and prospective economic conditions; and
- (h) weaknesses in loan administration and volume of criticized loans;
- (i) changes in lending staff or loan portfolio mix; and
- (j) implementation of new lending programs.

(2) The program shall provide for a review of the Allowance by the Board at least once each calendar quarter. Any deficiency in the Allowance shall be remedied in the quarter it is discovered, prior to the filing of the Consolidated Reports of Condition and Income, by additional provisions from earnings. Written documentation shall be maintained indicating the factors considered and conclusions reached by the Board in determining the adequacy of the Allowance.

(3) The Board shall ensure that the Bank has processes, personnel, and control systems to ensure implementation of and adherence to the program developed pursuant to this Article.

#### ARTICLE VII - QUARTERLY PROGRESS REPORTING

(1) The Board shall submit quarterly progress reports to the Assistant Deputy Comptroller, Minneapolis North Field Office (Assistant Deputy Comptroller). These reports shall set forth in detail:

- (a) actions taken to comply with each Article of the Agreement;
- (b) results of those actions; and
- (c) a description of the actions needed to achieve compliance with each Article of this Agreement.

(2) The progress reports should also include any actions initiated by the Board and the Bank pursuant to the criticisms and comments in the ROE or in any subsequent Report of Examination.

(3) The first progress report shall be submitted for the period ending July 31, 2001

and will be due within ten (10) days of that date. Thereafter, progress reports will be due within ten (10) days after the quarter end.

### CLOSING

(1) Although the Board has agreed to submit certain programs and reports to the Assistant Deputy Comptroller for review or approval, the Board has the ultimate responsibility for proper and sound management of the Bank.

(2) It is expressly and clearly understood that if, at any time, the Comptroller deems it appropriate in fulfilling the responsibilities placed upon him by the several laws of the United States of America to undertake any action affecting the Bank, nothing in this Agreement shall in any way inhibit, estop, bar, or otherwise prevent the Comptroller from so doing.

(3) Any time limitations imposed by this Agreement shall begin to run from the effective date of this Agreement. Such time requirements may be extended in writing by the Assistant Deputy Comptroller for good cause upon written application by the Board.

(4) The provisions of this Agreement shall be effective upon execution by the parties hereto and its provisions shall continue in full force and effect unless or until such provisions are amended in writing by mutual consent of the parties to the Agreement or excepted, waived, or terminated in writing by the Comptroller.

IN TESTIMONY WHEREOF, the undersigned, authorized by the Comptroller, has hereunto set his hand on behalf of the Comptroller.

/s/ Thomas J. Tott

6/18/01

\_\_\_\_\_  
Assistant Deputy Comptroller  
Minneapolis North Field Office

\_\_\_\_\_  
Date



IN TESTIMONY WHEREOF, the undersigned, as the duly elected and acting Board of Directors of the Bank, have hereunto set their hands on behalf of the Bank.

	<b>SIGNATURE:</b>	<b>DATE:</b>
Charles T. Chairs	<u>/s/ Charles T. Chairs</u>	<u>6/28/01</u>
Thomas Clure	<u>/s/ Thomas Clure</u>	<u>6-28-01</u>
Douglas Hiza, M.D.	<u>/s/ Douglas Hiza</u>	<u>6/28/01</u>
Melanie Mogg	<u>/s/ M. H. Peyton</u>	<u>6/28/01</u>
John E. Peyton	<u>/s/ J. E. Payton</u>	<u>6-28-01</u>
A. Nancy /Peyton	<u>/s/ Nancy A. Peyton</u>	<u>6-28-01</u>
Newton H. Peyton	<u>/s/ N. K. Peyton</u>	<u></u>