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**SUPERVISORY AGREEMENT**

This Supervisory Agreement (Agreement) is made and is effective this 5th day of MAY, 2000 (Effective Date), by and between **St. James Federal Savings and Loan Association** (Association), a mutual savings association having its main office located in **St. James, Minnesota**, and the Office of Thrift Supervision (OTS), an office within the United States Department of the Treasury, having its principal executive offices located at 1700 G Street, N.W., Washington, D.C., acting through its Midwest Regional Director or his/her designee (Regional Director).

**WHEREAS**, OTS is the primary federal regulator of the Association; and

**WHEREAS**, based on the Report of Examination dated December 20, 1999 (ROE), OTS is of the opinion that the Association has engaged in acts and practices that: (i) have resulted in violations of certain of the laws or regulations to which the Association is subject; and (ii) are considered to be unsafe and unsound; and

**WHEREAS**, OTS is of the opinion that grounds exist for the initiation of administrative proceedings against the Association; and

**WHEREAS**, OTS is of the view that it is appropriate to take measures intended to ensure that the Association will: (i) comply with all applicable laws and regulations, and (ii) engage in safe and sound practices; and

**WHEREAS**, the Association, acting through its Board of Directors (Board), and without admitting or denying any violations of laws or regulations and/or unsafe and unsound practices, wishes to cooperate with OTS and to evidence its intent to: (i) comply with all applicable laws and regulations, and (ii) engage in safe and sound practices.

**NOW THEREFORE**, in consideration of the above premises, the mutual undertakings set forth herein, the parties hereto agree as follows:

**COMPLIANCE WITH LAWS, REGULATIONS & SAFE AND SOUND PRACTICES**

**1. Compliance with Regulations**

The Association shall take all necessary and appropriate actions to achieve compliance with the following:

- (a) 12 C.F.R. Section 560.101 (regarding real estate lending standards);
- (a) 12 C.F.R. Section 560.170 (regarding records for lending transactions);
- (b) 12 C.F.R. Section 562.1 (regarding regulatory reporting requirements);
- (c) 12 C.F.R. Section 562.2 (regarding regulatory reporting standards);
- (d) 12 C.F.R. Part 564 (regarding required appraisals); and

- (e) 12 C.F.R. Part 570, Appendix A (regarding interagency guidelines establishing standards for safety and soundness).

### CORRECTIVE PROVISIONS

#### 2. Asset Review and Classification Policy

- (a) By May 12, 2000, the Board must provide to OTS a written confirmation that the Association's management has included additional assets that were identified at the OTS on-site examination, as reported in the ROE, in the Association's reported level of classified assets.
- (b) Prior to removing the Eppeland Tri-County Construction loans (Eppeland loans) from substandard classification, the Association's management must obtain and submit to OTS (i) the borrower's financial statements, and (ii) a financial analysis that demonstrates the borrower's ability to repay the Eppeland loans.
- (c) The Board shall have overall responsibility for oversight and proper implementation of the Association's current asset review and classification policy. The Board shall periodically monitor the policy and its implementation to ensure its effectiveness. The Board shall submit to the Regional Director for non-objection any material revisions to the policy that are suggested based on its monitoring of the policy.

#### 3. Lending Policies

- (a) Beginning as of the Effective Date of this Agreement, the Association shall not originate any additional construction loans until the Regional Director notifies the Association that he has no objection to lending policies and procedures developed pursuant to Paragraph 3(c) of this Agreement.
- (b) By May 12, 2000, the Board shall provide to OTS a detailed status report on the progress that the Association's management has made to correct loan deficiencies for all types of lending and loan participations identified in the ROE, including, but not limited to, lack of lien waivers, lack of inspections, appraisal deficiencies, lack of collateral documentation, and lack of construction status reports.
- (c) By May 31, 2000, the Board and Association's management shall undertake to determine whether the Association has, or can obtain, adequate resources to prudently underwrite and adequately document (i) commercial real estate; (ii) nonmortgage; and (iii) construction loans. Such determination shall include, but not be limited to, a cost/benefit analysis. If the Board has determined that the Association has adequate resources to continue making

these loans, then the Board shall develop and submit to OTS by May 31, 2000, for non-objection by the Regional Director, a written lending policy that addresses all lending, including but not limited to construction lending (Policy). The Policy shall, at a minimum, address requirements contained in 12 C.F.R. Sections 560.101 and 560.170, and 12 C.F.R. Part 570, Appendices A.II.C. and A.II.D.

- (d) After receiving no objection from the Regional Director, the Board shall implement the Policy described in Paragraph 3(c) of this Agreement, and shall submit to the Regional Director for non-objection any material revisions to the Policy.

#### **4. Recordkeeping and Reporting**

By May 12, 2000, the Board shall adopt policies and procedures to maintain adequate and accurate financial records in accordance with the requirements of 12 C.F.R. Section 562.1, and to ensure the completion and submission to OTS of accurate Thrift Financial Reports (TFRs), and accurate CMR reports as part of those TFRs, as required by 12 C.F.R. Section 562.2.

#### **5. Interest-Rate-Risk**

- (a) By May 12, 2000, the Board and the Association's management shall develop and submit to OTS for non-objection by the Regional Director an amended interest-rate-risk policy (IRR Policy) that complies with 12 C.F.R. Section 563.176 and 12 C.F.R. Part 570, Appendix A.II.E.; and follows the Guidelines of OTS Thrift Bulletin (TB) 13a, dated December 1, 1998. The IRR Policy must outline plans to significantly reduce the Association's interest-rate-risk to an acceptable level (moderate risk level under TB 13a guidelines) within specific time frames. The Board shall submit to the Regional Director for non-objection any material revisions to the IRR Policy.
- (b) By May 12, 2000, the Board shall adopt and submit to the OTS (i) a written resolution verifying that the Board is receiving and will continue to receive a monthly report from the Association's management on aggregate unrealized losses on securities; and (ii) a copy of that report.
- (c) Beginning as of the effective date of this Agreement, the Board and Association's management must not purchase, sell, or exchange any complex securities without first obtaining the written approval of OTS.
- (d) By May 12, 2000, the Board and the Association's management shall develop and submit to the OTS for non-objection by the Regional Director an amended investment policy (Investment Policy) that (i) incorporates changes required by TB 13a; (ii) addresses the permissible use of securities as

available for sale and trading portfolios (AFS); (iii); complies with the IRR Policy; (iv) requires Board pre-approval for purchase of any complex securities; and (v) requires the Board to receive from management and review quarterly status reports in accordance with 12 C.F.R. Section 563.176(d).

- (e) Once implemented, the Board shall submit to the Regional Director for non-objection any material revisions to the Investment Policy.
- (f) By May 12, 2000, and by the end of the month following each quarter end thereafter, the Board shall submit to OTS a written report detailing market gains and losses in the Association's securities portfolio as of the most recent quarter end.

## 6. Internal Controls and Operations

- (a) By May 12, 2000, the Board and the Association's management must submit to OTS written notification that they (i) have a plan to correct the internal control exceptions reported by the independent auditor, including, but not limited to, segregation of duties, written policies limiting cash balances; loan administration; data processing; and the need for additional use of personal computers; and (ii) have implemented procedures to comply with the guidelines contained in 12 C.F.R. Part 570, Appendix A.II.A.
- (b) By May 12, 2000, the Board and the Association's management must submit to OTS a report on the status of the U.S. Labor Department audit of possible violations of labor rules involving payment of overtime.
- (c) By May 31, 2000, the Board and the Association's management shall develop and submit for non-objection by the Regional Director an operating plan (Operating Plan) that, at a minimum, addresses:
  - (i) ability of the Association to commit sufficient resources to enable the Association to engage in authorized lending and investment activities in a safe and sound manner;
  - (ii) periodic monitoring of the Association's lending practices and ability to make construction, commercial real estate, and nonmortgage loans;
  - (iii) financial projections for three years; and
  - (iv) strategies to decrease market losses in its investment securities portfolio beginning immediately.
- (d) Once the Operating Plan is approved, the Board and the Association's management shall implement and comply with it, and shall provide to OTS variance reports at least quarterly to assure that projections are being achieved and that the Plan's goals do not need revising. The Board shall

submit to the Regional Director for non-objection any revision to the Operating Plan.

## MISCELLANEOUS

### 7. Director Responsibility

Notwithstanding the requirements of this Agreement that the Board submit various matters to the Regional Director or his designee for the purpose of receiving his approval, non-objection or notice of acceptability, such regulatory oversight does not derogate or supplant each individual member's continuing fiduciary duty. The Board shall have the ultimate responsibility for overseeing the safe and sound operation of the Association at all times, including compliance with the determinations of the Regional Director or his designee as required by this Agreement.

### 8. Compliance with Agreement

- (a) The Board and officers of the Association shall take immediate action to cause the Bank to comply with the terms of this Agreement, and shall take all actions necessary or appropriate thereafter to cause the Association to continue to carry out the provisions of this Agreement.
- (b) The Board, on a quarterly basis, shall adopt a board resolution (Compliance Resolution) formally resolving that, following a diligent inquiry of relevant information (including reports of management), to the best of its knowledge and belief, during the immediately preceding calendar quarter, the Association has complied with each provision of this Agreement currently in effect, except as otherwise stated. The Compliance Resolution shall specify in detail how, if at all, full compliance was found not to exist; and identify all notices of exemption or non-objection issued by the Regional Director that were outstanding as of the date of its adoption.
- (c) The minutes of the meeting of the Board shall set forth the following information with respect to the adoption of each Compliance Resolution: (i) the identity of each director voting in favor of its adoption; and (ii) the identity of each director voting in opposition to its adoption or abstaining from voting thereon, setting forth each such director's reasoning for opposing or abstaining.
- (d) No later than the 25th calendar day of the month following the end of a calendar quarter, beginning with the end of the first calendar quarter following the Effective Date, the Association shall provide to the Regional Director a certified true copy of the Compliance Resolution[s] adopted at the Board meeting in such calendar quarter. The Board, by virtue of the Association's submission of a certified true copy of each such Compliance Resolution to

the Regional Director, shall be deemed to have certified to the accuracy of the statements set forth in each Compliance Resolution, except as provided below. In the event that one or more Directors do not agree with the representations set forth in a Compliance Resolution, such disagreement shall be noted in the minutes of the Association.

9. **Definitions**

- (a) All technical words or terms used in this Agreement for which meanings are not specified or otherwise provided by the provisions of this Agreement shall, insofar as applicable, have meanings as defined in Chapter V of Title 12 of the Code of Federal Regulations, HOLA, FDIA, or OTS Memoranda. Any such technical words or terms used in this Directive and undefined in said Code of Federal Regulations, HOLA, FDIA, or OTS Memoranda shall have meanings that are in accordance with the best custom and usage in the savings and loan industry.
- (b) For purposes of this Agreement, the term "complex securities" includes any collateralized mortgage obligation, real estate mortgage investment conduit, callable mortgage pass-through security, stripped-mortgage-backed-security, structured note, and any security not meeting the definition of an "exempt security." An "exempt security" includes non-callable, "plain vanilla" instruments of the following types: (1) mortgage-pass-through securities; (2) fixed-rate securities; and (3) floating-rate securities.

10. **Successor Statutes, Regulations, Guidance, Amendments**

Reference in this Agreement to provisions of statutes, regulations, and OTS Memoranda shall be deemed to include references to all amendments to such provisions as have been made as of the Effective Date and references to successor provisions as they become applicable.

11. **Notices**

Except as otherwise provided herein, any request, demand, authorization, direction, notice, consent, waiver or other document provided or permitted by the Directive to be made upon, given or furnished to, delivered to, or filed with OTS or the Association shall be in writing and mailed, first class or overnight courier, or means of electronic transmission, or physically delivered, and addressed as follows:

OTS: Midwest Regional Office  
122 W. John Carpenter Fwy.  
Suite 600  
Irving, TX 75039  
(972) 281-2000 - Main Number  
(973) 281-2001 - Main Facsimile

Association: St. James Federal Savings  
and Loan Association  
501 First Avenue South  
St. James, MN 56081-0516  
(507) 375-3177 - Main Number  
(507) 375-3179 - Main Facsimile

**12. Duration, Termination or Suspension of Agreement**

(a) This Agreement shall: (i) become effective upon its execution by OTS, through its authorized representative whose signature appears below; and (ii) remain in effect until terminated, modified or suspended in writing by OTS, acting through its Director or the Regional Director (including any authorized designee thereof).

(b) The Regional Director in his or her sole discretion, may, by written notice, suspend any or all provisions of this Agreement.

**13. Time Limits**

Time limitations for compliance with the terms of this Agreement run from the Effective Date, unless otherwise noted.

**14. Effect of Headings**

The Section headings herein are for convenience only and shall not affect the construction hereof.

**15. Separability Clause**

In case any provision in this Agreement is ruled to be invalid, illegal or unenforceable by the decision of any Court of competent jurisdiction, the validity, legality and enforceability of the remaining provisions hereof shall not in any way be affected or impaired thereby, unless the Regional Director in his/her sole discretion determines otherwise.

**16. No Violations of Law, Rule, Regulation or Policy Statement Authorized; OTS Not Restricted**

Nothing in this Agreement shall be construed as: (i) allowing the Association to violate any law, rule, regulation, or policy statement to which it is subject; or (ii) restricting OTS from taking such action(s) that are appropriate in fulfilling the responsibilities placed upon it by law, including, without limitation, any type of supervisory, enforcement or resolution action that OTS determines to be appropriate.

**17. Successors in Interest/Benefit**

The terms and provisions of this Agreement shall be binding upon, and inure to the benefit of, the parties hereto and their successors in interest. Nothing in this Agreement, express or implied, shall give to any person or entity, other than the parties hereto and the Federal Deposit Insurance Corporation and their successors hereunder, any benefit or any legal or equitable right, remedy or claim under this Agreement.

**18. Signature of Directors**

Each Director signing this Agreement attests, by such act, that she or he, as the case may be, voted in favor of the resolution, in the form attached to this Agreement, authorizing the execution of this Agreement by the Association.

**19. Integration Clause: Impact On Other Enforcement Documents**

This Agreement represents the final written agreement of the parties with respect to the subject matter hereof and constitutes the sole agreement of the parties as of the Effective Date, with respect to such subject matter.

**20. Enforceability of Agreement**

The Association represents and warrants that this Agreement has been duly authorized, executed, and delivered, and constitutes, in accordance with its terms, a valid and binding obligation of the Association. The Association acknowledges that this Agreement is a "written agreement" entered into with OTS within the meaning of Section 8 of the FDIA, 12 U.S.C. Section 1818.

IN WITNESS WHEREOF, OTS, acting by and through the Regional Director, and the Association, in accordance with a duly adopted resolution of its Board (copy attached hereto), hereby execute this Agreement as of the Effective Date.

OFFICE OF THRIFT SUPERVISION

ST. JAMES FEDERAL SAVINGS,  
AND LOAN ASSOCIATION

By:

By:

151  
Frederick R. Casteel  
Midwest Regional Director

151  
Mark A. Larson  
President

~~DIRECTORS~~ DIRECTORS OF THE ASSOCIATION

151  
Mark A. Larson, Director

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Lester L. Reckow, Director

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David A. Bachelder, Director

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Steven P. Jeppson, Director

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Harold J. Wolle, Jr., Director

**CERTIFIED COPY OF  
RESOLUTION OF BOARD OF DIRECTORS**

I, the undersigned, being the duly appointed and qualified Secretary of St. James Federal Savings and Loan Association, St. James, Minnesota (Association) hereby certify as follows:

1. A duly called meeting of the Board of Directors of the Association was held on MAY 3, 2000;
2. At said meeting a quorum was present and voting throughout;
3. The following is a true copy of resolutions duly adopted by the Association's Board of Directors, which resolutions have not been rescinded or modified and are now in full force and effect:

**WHEREAS**, the Board of Directors of the Association wishes to cooperate with OTS, and to demonstrate that said Board and the Association intend to: (1) comply with all applicable laws and regulations and (2) engage in safe and sound practices; and

**WHEREAS** the Directors of the Association have read and considered the proposed Supervisory Agreement ("Agreement") which shall be attached to the minutes of this meeting; and

**WHEREAS** after due consideration, the Directors of the Association have determined to cause the Bank to enter into the proposed Agreement which is in the best interest of the Association;

**NOW THEREFORE, BE IT RESOLVED**, that the Association be and it hereby is authorized to enter into the Agreement in the form attached to the minutes of the meeting,

**FURTHER RESOLVED**, that the execution and delivery of, and performance of all of the provisions of the Agreement be, and they hereby are, authorized and approved,

**FURTHER RESOLVED**, that the Directors and Officers of the Association be, and they hereby are, authorized and directed to execute and deliver the Agreement and to take all steps necessary or appropriate to implement the terms of the Agreement and to cause the Association to comply in all respects with the terms of the Agreement.

4. All members of the Board of Directors were present and voted at the meeting (except \_\_\_\_\_) and all members of the Board of

Directors (except \_\_\_\_\_) voted in favor of the resolution;

IN WITNESS WHEREOF, I have hereto subscribed my name and affixed the seal of the Association on this 3RD day of MAY 2000.

ISI  
Name: \_\_\_\_\_

Title: PRESIDENT / CEO

(SEAL)