Bank Holding Company Association

First Quarter, 2008

Newsletter

Volume 22, No. 1

Bank? Or, Amusement Park?

By Jeff Judy

Jeff Judy is a Minneapolis-based consultant to the banking industry and an Associate Member of the Bank Holding Company Association.

Do you like roller coasters, the faster and scarier the better? Or, is the merry-go-round more your speed?

Your appetite for thrills and daredevil risks is a personal taste, of course . . . at the amusement park.

But what about your banking business?

The Roller Coaster Culture

Even if you do like the craziest rides at the amusement park, do you want your company to feel like a roller coaster?

How about your customers and investors? Do they want a bank that is thriving one year and in crisis the next?

Probably not. Whatever we may enjoy at the amusement park, as business people, most of us dislike surprises.

As bankers, we analyze our customers to gauge whether they are on sensible paths toward reasonable goals. We become concerned when we see unrealistic ambitions (to be achieved with our depositors' money), when irresistible short term opportunities blind them to long term consequences.

But as an industry, for various reasons, we have a long history of behaving in ways we hate to find among our customers!

"If Johnny jumped off a bridge . . ."

Remember when you were a kid and badly wanted to do something your parents didn't agree to? You tried to persuade them with the argument that one of your friends was doing it, that his or her parents thought it was okay. And then your mom asked if you would follow Johnny over the rail . . .

Well, if you and Johnny were both banks, you probably would. The herd instinct is very strong in the banking industry. Whether it is the current mortgage-related mess, or ag lending, or commercial real estate, or loans to developing countries, banks have charged off, in unison, toward one disaster after another.

Natural human tendencies support this folly: When we look at a roller coaster, the peaks are a lot easier to see than the valleys. We see how high we could go, what a great view we'll have, overlooking how far and fast we will eventually fall. In financial terms, we can't resist experiencing the highs of increased revenue and easy growth, and that blinds us to the costs and risks of concentrations and relaxed quality control.

We are obsessed with matching the competition. If we see a rival make a quick buck, we can't stand it. We follow their lead, not stopping to think that the rival will later lose two bucks on that deal, and so will we.

Discipline Is Difficult

Breaking this addiction to following the rest of the herd onto the roller coaster is very challenging. We look for "disciplined management" in the businesses we lend

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President's Column

Patrick J. Gates
Security Financial Services, Inc.
Hibbing, Minn.

The increase in home foreclosures caused by souring subprime mortgages is stirring lawmakers, regulators, community groups and media. The bursting of the housing bubble is at the foundation of our slowing economy. Given that all the pundits have weighed in on this, I thought I might like to use this platform to share a few of my own thoughts.

First, community banks did not cause this problem. Wall Street investors fueled the subprime mortgage phenomenon by funding borrowers who previously had not been considered creditworthy. Mortgage brokers placed the loans coming through mortgage companies and other non-bank lenders.

Second, as those borrowers are now beginning to demonstrate why they were not creditworthy in the first place, people are pointing fingers. Whose fault is it? Are the investors to blame? How about brokers, borrowers, rating agencies, or regulators? Pick any group you want, but the fact is the result impacts just about all of us.

Third, lawmakers are taking a close look at the mortgage origination process. Many believe new laws are necessary. Some of the legislation being considered attempts to open up new refinancing options through the Federal Housing Administration or one of the housing GSEs. Some folks are even using the word "bailout," suggesting that the government help underwater borrowers stay in their homes.

Four, the real impact of the housing situation on community banks in the Midwest might actually come from the slowing of the commercial real estate market. Many homebuilders have suspended projects, given over-supply and falling prices. The result is slower loan demand and, in some cases, deteriorating quality of loans already on the books.

And fifth, there may be opportunity in all of this. The debacle is creating a new sentiment that home buyers should return to traditional financing arrangements. The so-called experts are beginning to acknowledge that arrangements where borrowers and lenders know each other are beneficial. Loans have a higher probability of succeeding when borrowers and lenders share the same community, possibly even the same values.

So much mortgage business has migrated away from community banks in the last decade or so, but I think recent events might fuel a turn-around in that trend. ■

Welcome New Members

The Bank Holding Company Association is pleased and honored to welcome the following new members who have joined our Association:

Herbert L. Lallemont, President/CEO
Waumandee Bancshares, Ltd., Waumandee, Wis.

Gary Petersen, President
Lakeside Bank Holding Co., New Town, N.D.

Robert Sorenson, Treasurer
Davis Bancshares, Inc., McClusky, N.D.

In addition, the Association welcomes the following new associate members who have joined us in 2007:

Mark Blake, Partner
Bank Financial Services Group, Edina, Minn.

Troy Case, CEO
CASE, Anoka, Minn.

Timothy D. Moratzka, Attorney
Mackall, Crounse & Moore, PLC, Minneapolis

Gerald Raley, President
Global Adjusters Debt Collection, Burnsville, Minn.

Joshua R. Reding, Risk Management Sales Executive
RJF Agencies, Minneapolis

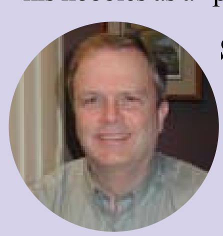
MEET THE NEW BHCA DIRECTORS

Douglas L. Farmer

Douglas L. Farmer is Executive Vice President of Park Bank, formerly known as Bank of Holmen, Wis. Farmer graduated in 1971 from George Washington University, Washington, D.C., with a Bachelor's of Arts degree in Public Administration. He began his career as a loan officer at Batavian National Bank in La Crosse, Wis. and was a finance instructor at Western Wisconsin College in La Crosse from 1977 to 1980. Farmer has been with Park Bank since 1981.

Farmer is on the State of Wisconsin Banking Review Board, the La Crosse City Council, and has previously served as President of the La Crosse School Board, Chairman of the Search & Screen Committee for a new college president for Western Wisconsin Technical College and Finance Chairman for the La Crosse County Board of Supervisors.

Farmer and his wife, Betsey, have four sons. He lists his hobbies as a "passion for Studebakers."



Steve Gilmer

Steve Gilmer has been with the State Bank of Delano since 1973 and has served as its Presi-

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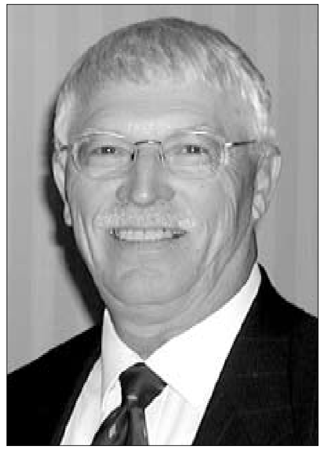
The BHCA Newsletter is published quarterly by the Bank Holding Company Association for its members. To submit an article, please contact BHCA Executive Director Dennie Emmans at 763-784-3222 or 1-800-813-4754. FAX: 763-784-4546, e-mail: wdebhca@aol.com.

Director's Column

By W. Dennie Emmans
Executive Director



The Bank Holding Company Association's 2008 Spring Seminar will be held on Monday and Tuesday, May 5 and 6, 2008, at the Minneapolis Airport Marriott Hotel in Bloomington, Minn.

The theme for our 54th semi-annual conference is "***Ownership Strategies for Today's Economy***" and should once again prove to be one of those "must attend" events for bank owners, executive officers and bank directors who wish to become informed on current regulatory, legislative, ownership and strategic planning issues within the financial services industry.

Our Monday, May 5th reception and dinner program will feature political humorist **Will Durst**. Durst, according to the *New York Times*, is "quite possibly the best political satirist working in the country today" and is universally acknowledged by his peers as the nation's foremost political comic.

Our featured noon luncheon speaker for Tuesday, May 6th is **Lori Swanson**, Attorney General for the State of Minnesota, who will address many issues within the mortgage banking industry including subprime lending, predatory lending and several other related banking practices.

A special noon luncheon presentation will be made by **Dick Swanson**, President of the Federal Home Loan Bank of Des Moines, who will discuss current issues and developments at the Federal Home Loan Bank.

Our keynote speaker for the Tuesday, May 6th general session is the well-known industry consultant, **Jeff Judy**, whose presentation entitled "***Banking Today and Its Changing Environment***" will provide insight to improve the credit quality of your loan portfolio.

An additional general session presentation will be made by economist and banking industry consultant, **Carl Tannenbaum**, who will review current economic conditions and provide his projections for the coming year and their impact on the financial services industry.

In addition, several workshop sessions will be held on a variety of timely topics within the financial services industry including:

- Strategies for Today's Real Estate Market
- Recent Trends in Mergers and Acquisitions
- Risk Management Insurance Strategies
- Optimizing Shareholder Value
- Asset Liability Management/Investment Strategies

You will not want to miss any of this vital information, so mark these dates on your calendar now and watch for registration information to be mailed soon.

By all indications, the BHCA Spring Seminar should once again prove to be "your best two days in banking." I look forward to seeing you on May 5 and 6, 2008.■

Payment system

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traditional financial institution and will also eliminate the lines our customers stand in and drive through!

Mobile Banking (Can you touch me now?) It is exactly what it says it is! Mobile banking takes the financial institution to the customer, whenever and, where ever they are. In this case, the customer is waiting on the financial industry to offer this product with the adoption rate being almost explosive. A case in point is that most individuals today may travel without their wallet or purse, but not without their cell phone. The next big leap will be in the form of a wireless or contactless interface that will enable the cell phone to be used at the point of sale. Settlement will not be, however, through the card networks but through the "telco," again bypassing the interchange fees. From boarding passes to season tickets at athletic events and concerts, the cell phone will become an indispensible payment system and transaction intermediary.

Generation T is the future! Don't wait for the tsunami that is swelling just beyond your view to become obvious before you realize that you need to change your thinking. Generation T are those individuals whom are 12 years old and younger. This group is the generation that is growing and learning in an environment that is fully integrated with technology in every aspect of their lives. Generation T will not tolerate any technology that requires them to be present to complete a transaction, carry or deliver paper, or have their access based on time of day. The message here is a simple one: if your product and service offering is not virtual, mobile and 24/7 accessible, your species of financial institution will soon become extinct. ■

Dan Fisher is president and CEO of The Copper River Group, Fargo, N.D.-based consulting firm that focuses on technology and payment systems for community financial institutions. Contact Dan at dan@copperwombat.com.

Bank? or Amusement park

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to, but it is time to demand it of ourselves.

"Discipline" is nothing more than:

• having the tools and methods to overcome human nature for a greater good, and

• applying those tools consistently.

It's the second step where most of us run into trouble. We let our most foolish competitor make the rules of the game. The disciplined bank is distinguished by a lack of exceptions to policy and procedures. If exceptions have become common in your operations, you either need to fix your policy, or to rediscover the discipline to follow your policy.

To build that discipline:

Recognize yourself in the picture I've painted above. If you imagine that this is a problem for everyone else, you're probably doomed to be on the next crazy ride.

Accept that the industry as a whole is unlikely to change. We have never learned our lesson, and we'll forget this time, too. If you follow the competition in the belief that banking as a whole won't repeat its mistakes, you'll be feeling the pain once more, several years down the road.

Make an explicit decision to be independent. Sometimes you will do things the same way your rivals do, sometimes you'll do something different. But in both situations, choose your actions for your reasons, not based on their reasons.

Brace yourself to miss out on some of the biggest short-term gains, in your pursuit of long-term profitability. If you can't accept steady growth and profits in place of the wild swings most banks see now, you don't have enough courage to break the cycle.

Get a broken record and play your standards and policies on it. Temptation is everywhere, and if your staff does not constantly hear what you expect, they will respond to what the competition does — which may or may not work for them, but you don't want your rivals driving your decisions.

Invest in what produces results for your plan, not what everyone else invests in. Take your own approach to technology, to training, to customer service. You're on a different path, and you must apply your resources differently to go down that better path.

Share your vision with your customers and shareholders. Over time you will surround yourself with those who value consistency and stability over high-risk, high-growth schemes.

Do You Have What It Takes?

This is not a program for the faint of heart. It takes strong management, effective systems, clear policies, and frequent communication.

Above all, it takes sheer guts. You'll give up some tempting customers, and turn off some potential investors . . . at least for now.

But if you can stick it out until the industry creates its next big mess, you'll shine. When all your competitors are dropped into the dunk tank, you'll be high and dry. You'll stand out in your marketplace as the better-run, more visionary operation.

You'd rather lend to better run, more disciplined businesses. Why not take the steps to be one? You'll give up a few thrills, but stick to your plan and you'll find that you don't miss that roller coaster one bit. ■

BHCA Spring Seminar to Headline LORI SWANSON, Attorney General for the State of Minnesota

Make plans now to attend the 54th semi-annual seminar of the Bank Holding Company Association at the

MINNEAPOLIS AIRPORT MARRIOTT HOTEL
2020 East American Boulevard, Bloomington, Minnesota

Monday, May 5, 2008

5:30 p.m. to 8:00 p.m.

RECEPTION, DINNER & PROGRAM:

"Will Durst"

Our after dinner program will feature political humorist **Will Durst**, Durst, according to the *New York Times*, is "quite possibly the best political satirist working in the country today" and is universally acknowledged by his peers as the nation's foremost political comic.

MARK YOUR CALENDAR TODAY!
Don't miss any of these great speakers and much, much more!!

May 5 & 6, 2008

EVENING SESSION FEES:
BHCA members and guests…...$ 75
Non-members……………………$ 100

GENERAL SESSION FEES:
BHCA members and guests…..$ 200
Non-members…………………...$ 250

Tuesday, May 6, 2008

8:30 a.m. to 3:30 p.m.

"Ownership Strategies for Today's Economy"

Our featured noon luncheon speaker for this seminar is **Lori Swanson**, Attorney General for the State of Minnesota who will address many issues within the mortgage banking industry including subprime lending, predatory lending and several other related banking practices.

A special noon luncheon presentation will be made by **Dick Swanson**, President/CEO of the Federal Home Loan Bank of Des Moines, who will discuss the latest developments at the Federal Home Loan Bank.

Our general session keynote speaker is the well-known industry consultant, **Jeff Judy**, whose presentation entitled ***"Banking Today and Its Changing Environment"*** will provide insight to improve the credit quality of your loan portfolio.

An additional general session will be made by economist and banking industry consultant, **Carl Tannenbaum** who will review current economic conditions and provide his projections for the coming year and their impact on the financial services industry.

In addition, several workshop sessions will be held to discuss: Mergers and Acquisitions, Strategies for Today's Real Estate Market, Risk Management Insurance Strategies, Optimizing Shareholder Value and Asset Liability Management/Investment Strategies.

To take advantage of the reduced hotel room rate contact the Minneapolis Airport Marriott Hotel at 952-854-7441 and mention that you are reserving for the BHCA Spring Seminar

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Banks eye acquisitions in effort to grab market share

Community bankers plan to compete for market share in 2008 by acquiring another institution, outsourcing traditional functions and harnessing technology, according to an American Bankers Association survey released in February. More than one-in-three (37 percent) of the 656 bankers responding plan to acquire another bank in the next five years. Only 7 percent expect to be purchased in that time. But respondents indicated that acquisition decisions are just part of the competitive mix.

"The survey results illustrate community bankers' desire to do more than their competitors, to offer products with more customer appeal, to improve business channels and more," said Steve Cocheo, executive editor of *ABA Banking Journal*, which sponsored the survey along with ABA's America's Community Bankers Council. "It is clear that many of the bankers responding intend for their institutions to not only to compete, but to win."

According to the 12th annual ABA Community Bank Competitiveness Survey, many banks hope to steer their bank to success by outsourcing some functions that were traditionally performed by bank staff.

Overall, more than one-third (37 percent) of the banks responding currently outsource some functions, and among banks over $1 billion, nearly half (49 percent) do so. Topping the list of traditional functions currently outsourced were internal audit (53 percent), loan review (49 percent) and compliance audit (46 percent). These were followed by item processing (45 percent), ATM servicing (28 percent) and IT management (25 percent).

"It's interesting to note that of the top four outsourcing choices, one is item processing, a mechanical function. But the other three are 'brain work' – all essential but requiring deep and expensive expertise," Cocheo said.

The majority of respondents outsourced to cut costs and obtain expertise – both at 60 percent – without having to create a full time position. And this practice will grow. Of those banks that do not currently outsource, 24 percent are actively considering outsourcing in the future.

In spite of the trend toward outsourcing, the survey results indicate that having technology expertise under the bank's own roof not only remains important, but actually increases with growth. Overall, 56 percent of community banks use their own staff as the chief source of tech expertise, followed by consultants (20 percent) and vendors (12 percent). But for banks over $1 billion that figure jumps to 96 percent.

This may explain why respondents ranked IT officers (49 percent) as the second most difficult position to fill, with business lenders (50 percent) in the top spot. Compliance officers round out the top three with 47 percent saying qualified candidates are "very hard" to find.

The survey examined bankers' opinions on a wide range of other topics. Some of the key findings:

On remote deposit capture of checks:

- The number of community banks that offer remote deposit capture more than doubled from 16 percent in 2007 to 38 percent today. And another 25 percent plan to offer in 2008.
- Most respondents (54 percent) said that RDC remains unprofitable. But 58 percent said they offer it purely to attract new business, and a whopping 71 percent used it to retain business clients.

On health savings accounts:

- More than half of the banks surveyed do not offer HSAs. However, 43 percent do offer them – a figure that represents a jump of 31 percent since 2007.
- Employer programs (39 percent) have proven to be the most productive market for HSAs, followed by professionals (29 percent), retail customers (24 percent) and other (9 percent).

On examinations:

- Bankers reported a shift in focus by exam teams from the Bank Secrecy Act (35 percent) to commercial real estate lending issues (39 percent), although BSA remained a very close second.
- Enterprise risk management continued to be a focus, even by exam teams visiting the smallest community banks. Bankers said examiners main expectations were to have a written program (66 percent), risk rating system (54 percent), with risk training (13 percent) and risk committee (11 percent) trailing behind. ■

New directors

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dent since 1985. Gilmer graduated in 1966 with a Bachelor's of Arts degree from St. Olaf College, Northfield, Minn., and received his MBA in 1968 from the University of Michigan, Ann Arbor.

Gilmer is very active in the local community. He is a founding member of the Delano Area United Way, the Delano Economic Development Corporation and the Delano 4th of July Committee. He previously served as Director and President of the Delano Area United Way, Director and President of the Delano Chamber of Commerce, Director and Vice Chairman of Functional Industries, Inc., President of the Wright County Bankers Association, Director of the State Bankers Association, has been active with the Delano Public Schools, the American Legion and is a Member of Delano United Methodist Church where he has also held several other leadership positions.

Gilmer and his wife, Cherryl, have three children and two grandchildren. ■

Payments system:
Everything is going electronic – are you?

By Dan Fisher

Looking ahead and trying to predict the future as it pertains to payments in the context of monetary transactions and financial institutions is not very hard these days. It will, for the most part, all be electronic. Fundamental to this prediction, however, is the form these electronic transactions will take.

An exit strategy and the Federal Reserve System. First, the effort of moving financial institutions to the electronic world of interbank payments and intermediary processing is going to receive a tremendous push. Back in the 1990s, the Federal Reserve made a decision to no longer receive or deliver ACH transaction tapes. Likewise, the FED will soon apply this same concept toward the transportation of paper checks.

I expect the Federal Reserve to announce an initiative that will end the physical delivery of paper checks and substitute checks back to the paying financial institution. The initiative would ask that each financial institution designate an electronic presentment point where in-clearing files should be presented for Reg. CC and settlement purposes. The Fed will then publish a standard file retrieval schedule and financial institutions will be responsible for retrieving their daily in-clearing files as they become available (like ACH files today). This initiative can be easily justified due to declining check volume and the increasing transportation costs.

ACH -- An effective alternative ACH transaction volume will continue to grow at an annual rate of 20 percent or more, but utilization of the ACH network will gain significant traction in three areas. One area is least cost routing in the form of intelligent transaction processing applications that automatically route Check-21 eligible transactions (using deposit automation and remote capture products) via ACH instead of image exchange networks.

Secondly, interchange avoidance systems, point of sale applications that use the ACH network for processing transactions thus bypassing card networks and avoiding interchange fees, will grow in popularity when linked to rewards-based programs.

And finally, intermediary payment systems (not financial institution specific) that are used on internet sites such as AOL, Google, eBay, Amazon and the like will see high double digit growth. In addition, these systems will begin to overtake conventional bill-pay applications due to simplicity of use, speed of set-up and the rewards program linkage for both consumers and businesses.

To emphasize my view, the ACH system is not the wave of the future, it is the Tsunami! More importantly, if you wait until the trend is obvious to make your payments system decision, it will be too late!

Digital Demand Accounts -- The new DDA! The Digital Demand Account will become the rage because it is all electronic and real time! The new account opening process will not include a checkbook or a paper statement. The new account will have a continuously updated statement and a virtual check register. The system also will notify you via cell phone text message that your paycheck has been deposited and that your mortgage and auto payments have been made!

In addition, the All-in-One printer that prints, faxes and scans will have two added features: A check scanner and a magnetic stripe reader. Retail customers and very small businesses will take advantage of remote deposit technology and plastic card products from their desk top computers at home. Check scanner prices will fall well below current pricing levels.

Imagination versus Imaging Unintended consequences can best describe the products of the Check 21 era. In real terms, Check 21 got us all to start thinking again! Some of the thinking has been sequential in as much that some vendors used Check 21 to create an electronic version of a paper process, a way to extend the life of an old system. Others saw an opportunity to re-think and re-tool. Ultimately, the back office will no longer be a necessary function or department within the traditional financial institution. Leadership fueled by imagination will blur the lines that separate departmental functions of the

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BHCA News

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In addition, notice filed by Gib Nichols Living Trust and Sarah Nichols Living Trust, Vancouver, Washington; James Brendan Nichols, West Linn, Oregon; Shaun Nichols, Tuscon, Ariz.; Norris Nichols, Helena, Mont.; Karyl Arndt, Aurora, Colo.; and Roseanne Heser, Mahtomedi, Minn., to gain control of Flathead Holding Company of Bigfork, Mont., and thereby gain control of Flathead Bank of Bigfork.

✔ Frandsen Financial Corp., Arden Hills, Minn., filed to acquire The First National Bank of Montgomery, Minn.

✔ Highland Bancshares, St. Paul, filed to acquire Ridgedale State Bank, Minnetonka, Minn.

✔NATCOM Bancshares, Inc., Superior, Wis., proposes to engage in lending activities, primarily purchasing loan participations from its subsidiary bank, National Bank of Commerce, Superior, Wis. ■

Bank Holding Company News

Following is a partial report of recent bank holding company filings with the Federal Reserve Bank of Minneapolis:

✔ Change in control notice filed by John M. Morrison Revocable Trust No. 4, to gain control of Central Bancshares, Inc., Golden Valley, Minn., and thereby gain control of Central Bank, Stillwater.

✔ Frandsen Financial Corp., Arden Hills, Minn., filed to acquire Anderson Financial Group, Inc., Wayzata, Minn., and thereby acquire Northern National Bank, Nisswa, Minn. Frandsen Financial Corp., also filed to acquire Tower Bancshares, Cloquet, Minn., and thereby acquire State Bank of Tower, Minn.

✔ Glacier Bank, Kalispell, Mont., filed to merge with Glacier Bank of Whitefish, Mont., and establish two branches in Whitefish and one in Eureka, Mont.

✔ Notice filed by Lloyd O. Olson, Lake Park, Minn., to retain 10 percent or more of the shares of Lake Park Bancshares, Inc., Lake Park, Minn., and thereby retain control of State Bank of Lake Park.

✔ Mills Financial Services, Inc., Brainerd, Minn., filed to become a bank holding company by acquiring First Security Bank-Sandborn, Minn.

✔ United Citizens 401(k) Savings Plan, Osseo, Wis., filed to become a bank holding company by acquiring up to 56 percent of the Class A common stock of United Bancorporation, Osseo, and thereby acquire United Bank, Osseo; Cambridge State Bank, Cambridge; Lincoln Community Bank, Merrill; Bank of Poynette; Clark County State Bank; Osceoloa, Iowa; Farmers State Bank, Stickney, S.D., and Farmers & Merchants State Bank, Iroquois, S.D.

✔ BancMidwest Corporation, St. Paul, filed to acquire Hiawatha Bancshares, Inc., Hager City, Wis., and thereby acquire Hiawatha National Bank.

✔ Notice filed by Lawrence W. Jochim Revocable Trust, Bigfork, Mont.; Cindy Jochim and Richard Jochim, both of Bigfork; Todd Jochim, Lakeside, Mont.; Lesley Jungers, Seeley Lake, Mont.; Karla Langlois, Missoula, Mont.; and Marcus Jochim and Beverly Jochim, both of Inverness, Mont., to gain control of Flathead Holding Company of Bigfork, and thereby gain control of Flathead Bank of Bigfork.

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