

UNITED STATES OF AMERICA  
BEFORE  
THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON, D.C.

_____ )	
Written Agreement by and between )	
)	
RIDGEDALE STATE BANK )	Docket No. 03-024-WA/RB-SM
Minnetonka, Minnesota )	
)	
FEDERAL RESERVE BANK )	
OF MINNEAPOLIS )	
Minneapolis, Minnesota )	
_____ )	

WHEREAS, in recognition of their common goal to ensure and maintain the financial soundness of the Ridgedale State Bank, Minnetonka, Minnesota (the "Bank"), a state-chartered bank that is a member of the Federal Reserve System, the Bank and the Federal Reserve Bank of Minneapolis (the "Reserve Bank") have mutually agreed to enter into this Written Agreement (the "Agreement"); and

WHEREAS, on July 28, 2003, the board of directors, at a duly constituted meeting, adopted a resolution authorizing and directing Frederick Winston to enter into this Agreement on behalf of the Bank, and consenting to compliance by the Bank and its institution-affiliated parties, as defined in section 3(u) of the Federal Deposit Insurance Act, as amended (the "FDI Act") (12 U.S.C. 1813(u)), with each and every provision of this Agreement.

NOW, THEREFORE, the Bank and the Reserve Bank agree as follows:

**Management Review**

1. (a) Within 20 days of this Agreement, the board of directors shall retain an independent consultant acceptable to the Reserve Bank to conduct a review of the functions and

performance of the Bank's board of directors, senior management, and auditor (the "Review") and to prepare a written report of findings and recommendations (the "Consultant's Report").

The terms of the contract with the consultant shall require that the Review be completed within 60 days of the retention of the independent consultant and that the Consultant's Report be submitted to the board of directors within 10 days of the completion of the Review. The Review shall, at a minimum, address, consider, and include:

- (i) the identification of the type and number of officer positions needed to manage and properly supervise the Bank's affairs;
- (ii) an evaluation of each senior officer and the auditor to determine whether the individual possesses the ability, experience, and other qualifications required to competently perform present and anticipated duties, to adhere to the Bank's established policies and procedures, to ensure and maintain the Bank in a safe and sound condition, and to comply with the requirements of this Agreement;
- (iii) an assessment of the current structure and composition of the board of directors and any committees thereof and a determination of the structure and composition needed, including the range and depth of experience of the directors, to adequately supervise the affairs of the Bank; and
- (iv) the identification of individuals at the Bank who are considered to have the potential for advancement or promotion to ensure adequate successor management.

(b) The primary purpose of the Review shall be to aid in the development of an effective board of directors and a management structure suitable to the Bank's needs that is adequately staffed by qualified and trained personnel. At a minimum, the qualifications of management shall be determined by its ability to (i) ensure and maintain all aspects of the Bank in a safe and sound condition; and (ii) comply with the requirements of this Agreement and all applicable laws and regulations. The Bank shall forward a copy of the Consultant's Report to the Reserve Bank within 5 days of its receipt.

(c) Within 45 days of the Bank's receipt of the Consultant's Report, the Bank shall submit a written management plan (the "Management Plan") to the Reserve Bank that fully addresses the findings and recommendations in the Consultant's Report and describes the specific actions that the board of directors propose to take in order to strengthen the Bank's management.

(d) Within 120 days of this Agreement, and thereafter semiannually, the board of directors shall review management's adherence to the Bank's written policies, procedures, and applicable laws and regulations. The board of directors shall prepare written findings and conclusions of this review along with written descriptions of any management or operational changes that are made as a result of the review and shall forward a copy to the Reserve Bank.

### **Board Oversight**

2. Within 45 days of the Bank's receipt of the Consultant's Report, the board of directors shall submit to the Reserve Bank a written plan to enhance board oversight of the Bank's management and operations. The plan shall, at a minimum, address, consider, and include:

(a) The actions that the board of directors will take to enhance the Bank's condition and maintain effective control over and supervision of the Bank's senior management, major operations, and activities, including, at a minimum:

- (i) an independent and effective audit function;
- (ii) effective internal controls;
- (iii) an independent loan review system;
- (iv) risk management; and
- (v) training programs for the board of directors, management, and staff.

(b) The responsibility of the board of directors to monitor management's adherence to approved plans, policies, procedures, programs, and applicable laws and regulations;

(c) A description of the detailed information to be included in the periodic reports that will be reviewed by the board of directors in its oversight of the Bank's operations and management, including information sufficient to assess management's compliance with approved written plans, policies, procedures, programs, and applicable laws and regulations; and

(d) The criticisms related to the board of directors' oversight of management noted in the Report of the Examination of the Bank conducted by the Reserve Bank in December 2002 (the "Report of Examination") and the Consultant's Report.

### **Risk Management**

3. Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank an acceptable plan designed to strengthen and enhance the Bank's risk management practices. The plan shall, at a minimum, address, consider, and include:

(a) The identification of the Bank's major risk areas, including, but not limited to credit, market, liquidity, operational, legal, and reputational risks;

(b) The board of directors' and senior management's responsibilities for identifying, measuring, monitoring, and controlling risk;

(c) A review of the Bank's major policies to ensure that the policies adequately describe management responsibilities and lines of authority;

(d) Procedures for the board of directors to evaluate and approve new banking activities or product lines; and

(e) The risk management criticisms noted in the Report of Examination.

## **Audit and Internal Controls**

4. (a) During the term of this Agreement, the majority of the board of directors audit committee (the “Audit Committee”) shall continue to be comprised of outside directors.

The Audit Committee shall (i) meet at least monthly; (ii) maintain full and complete minutes of its actions; and (iii) report, in writing, to the full board of directors at least monthly.

(b) The Audit Committee shall be responsible for the oversight of the Bank’s audit and internal control functions and shall, at a minimum, ensure that (i) internal controls and information systems are adequately tested and reviewed; and (ii) audit coverage, procedures, findings, and management responses to audit findings are adequately documented.

(c) For the purposes of this Agreement, the term: (i) “outside director” is defined as an individual, not an employee or executive officer of the Bank or its parent bank holding company, Ridgedale Financial Services, Minnetonka, Minnesota (“RFC”), who owns less than 10 percent of the outstanding voting stock of the Bank or RFC, and who is not related in any manner to any shareholder who owns 10 percent or more of the outstanding voting stock of the Bank or RFC or any related interest of such a shareholder; and (ii) “executive officer” is defined as set forth in section 215.2(e) of Regulation O of the Board of Governors (12 C.F.R. 215.2(e)).

5. Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank an acceptable written plan to strengthen the Bank’s audit and internal control functions. The plan shall, at a minimum, address, consider, and include:

(a) Generally accepted auditing standards, including, without limitation, the scope and frequency of audits;

- (b) Direct lines of reporting between the auditors and Audit Committee and the board of directors;
- (c) Designation of resources adequate to ensure that internal audits are conducted by qualified staff, are performed for all areas that have been designated as warranting attention, and are completed as scheduled;
- (d) The requirements of the Interagency Policy Statement on the Internal Audit Function and Its Outsourcing, dated March 17, 2003;
- (e) The requirements of sections 2675.2600 and 2675.2610 of the Minnesota Department of Commerce Rules regarding internal controls and directors' examinations;
- (f) The timely submission to the Audit Committee and the board of directors of periodic audit reports and written management responses;
- (g) Periodic reviews to verify that management has addressed any deficiencies noted in audit recommendations;
- (h) Periodic review of the Bank's internal controls and information technology functions; and
- (i) Corrective steps that address the criticisms of the audit and internal control functions set forth in the Report of Examination.

### **Loan Review**

6. Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank an acceptable written loan review program designed to assess the overall quality of the Bank's loan portfolio and address the loan review criticisms described in the Report of Examination. The program shall, at a minimum, address, consider, and include:

- (a) The independent review of extensions of credit for compliance with the Bank's loan policies, procedures, and applicable laws and regulations;
- (b) A description of the risk grades to be assigned to each loan;
- (c) The designation of individuals responsible for determining loan grades, who have the requisite educational and professional qualifications to conduct an independent loan review;
- (d) Identification of the scope and frequency of loan grading;
- (e) The requirements outlined in Attachment I of the Interagency Policy Statement on the Allowance of Loans and Lease Losses, issued December 21, 1993, addressing the minimum requirements of loan review and credit grading systems;
- (f) Procedures to confirm the accuracy of all risk grades assigned by the Bank's loan officers; and
- (g) Periodic reporting to the board of directors of the status of the loan reviews and the action(s) taken by management to improve the Bank's position on each loan adversely graded.

**Information Security**

7. Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank an acceptable plan designed to enhance information security. The plan shall, at a minimum, provide for an information security risk assessment, as required by Appendix D-2 to Part 208 of the Regulation H of the Board of Governors (12 C.F.R. Part 208, App. D-2), to enable the Bank to meet all applicable requirements for protecting nonpublic customer information and to assist the Bank in making future appropriate adjustments to its information security safeguards.

## **Compliance with Laws and Regulations**

8. The Bank shall immediately take all necessary steps consistent with sound banking practices to correct all violations of laws and regulations set forth in the Report of Examination.

9. Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank an acceptable written compliance program designed to ensure compliance with all applicable federal and state laws, regulations, and supervisory requirements. Pursuant to the program, the directors and officers of the Bank shall familiarize themselves with applicable provisions of federal and state laws and regulations. The program shall, at a minimum, address, consider, and include:

- (a) The appointment of a compliance officer responsible for coordinating and monitoring compliance at the Bank;
- (b) Comprehensive compliance policies and procedures;
- (c) A plan for monitoring and testing compliance;
- (d) A compliance training program for Bank staff; and
- (e) The compliance criticisms noted in the Report of Examination.

## **Approval of Plans and Programs**

10. The written plans and programs and the identification of the independent consultant required by paragraphs 1(a), 3, 5, 6, 7, and 9 of this Agreement shall be submitted to the Reserve Bank for review and approval. Acceptable plans and programs shall be submitted within the time periods set forth in this Agreement and an acceptable independent consultant shall be retained within the time period set forth in paragraph 1(a) of this Agreement. The Bank shall adopt all approved plans and programs within 10 days of approval by the Reserve Bank and then shall fully comply with them. During the term of this Agreement, the approved plans and

programs shall not be amended or rescinded without the prior written approval of the Reserve Bank.

### **Compliance with Agreement**

11. Within 30 days after the end of each calendar quarter (September 30, December 31, March 31, and June 30) following the date of this Agreement, the board of directors shall furnish to the Reserve Bank written progress reports detailing the form and manner of all actions taken to secure compliance with this Agreement and the results thereof. Such reports may be discontinued when the corrections required by this Agreement have been accomplished and the Reserve Bank has, in writing, released the Bank from making further reports.

### **Communications**

12. All communications regarding this Agreement shall be sent to:

(a) Mr. Mark A. Rauzi  
Assistant Vice President  
Division of Supervision, Regulation, and Credit  
Federal Reserve Bank of Minneapolis  
90 Hennepin Avenue  
P.O. Box 291  
Minneapolis, Minnesota 55480-0291

(b) Mr. Frederick Winston  
Chairman  
Ridgedale State Bank  
1730 Plymouth Road  
Minnetonka, Minnesota 55305-1959

### **Miscellaneous**

13. Notwithstanding any provision of this Agreement to the contrary, the Reserve Bank may, in its sole discretion, grant written extensions of time to the Bank to comply with any provision of this Agreement.

14. The provisions of this Agreement shall be binding upon the Bank and its institution-affiliated parties, in their capacities as such, and their successors and assigns.

15. Each provision of this Agreement shall remain effective and enforceable until stayed, modified, terminated or suspended by the Reserve Bank.

16. The provisions of this Agreement shall not bar, estop or otherwise prevent the Board of Governors, the Reserve Bank, or any other federal or state agency from taking any other action affecting the Bank or any of its current or former institution-affiliated parties and their successors and assigns.

17. This Agreement is a "written agreement" for the purposes of, and is enforceable by the Board of Governors as an order issued under, section 8 of the FDI Act (12 U.S.C. 1818).

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the 29<sup>th</sup> day of July, 2003.

Ridgedale State Bank  
By: *Frederick L. Smith*  
Title: *Chairman*

Federal Reserve Bank of Minneapolis  
By: *Neil Mulford*  
Title: *Senior Vice President*