

FEDERAL RESERVE SYSTEM

Community Bankshares, Inc.
Greenwood Village, Colorado

Order Approving the Acquisition of a Bank Holding Company

Community Bankshares, Inc. (“Community”), a bank holding company within the meaning of the Bank Holding Company Act (“BHC Act”), has requested the Board’s approval under section 3 of the BHC Act¹ to acquire Citizens Financial Corporation (“Citizens”) and its subsidiary bank, The Citizens State Bank of Cortez (“Citizens State Bank”), both of Cortez, Colorado.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the Federal Register (71 Federal Register 68,817 (2006)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

Community, with total consolidated assets of approximately \$1.4 billion, operates the following subsidiary insured depository institutions in California and Colorado: Community Banks of Northern California, Tracy, California; and Community Banks of Colorado (“Community Bank”), Greenwood Village, Colorado. Community is the 17th largest depository organization in Colorado, controlling deposits of \$981.1 million, which represent 1.3 percent of total deposits of insured depository institutions in Colorado (“state deposits”).²

Citizens, with total banking assets of approximately \$78 million, operates one insured depository institution with branches only in Colorado.

¹ 12 U.S.C. § 1842.

² Data are as of June 30, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

Citizens is the 103rd largest depository organization in Colorado, controlling deposits of approximately \$65 million, which represent less than 1 percent of state deposits.

On consummation of this proposal, Community would remain the 17th largest depository organization in Colorado, controlling deposits of approximately \$1 billion, which represent 1.4 percent of state deposits.

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.³ The Board has considered carefully the competitive effects of the proposal in light of all the facts of record.

A. Geographic Banking Market

Community and Citizens compete directly in the Cortez, Colorado banking market (“Cortez banking market”). Community contends that the Cortez banking market, as delineated by the Federal Reserve Bank of Kansas City (“Reserve Bank”),⁴ does not reflect the true nature of banking competition in Cortez and that the relevant geographic market for analysis should be expanded to include La Plata County, where the city of Durango is located. Community

³ 12 U.S.C. § 1842(c)(1).

⁴ The Cortez banking market is defined as Dolores and Montezuma Counties, Colorado.

bases its contention on the commuting patterns between Montezuma and La Plata Counties.⁵

In defining a geographic market, the Board and the courts have consistently found that the relevant geographic market for analyzing the competitive effects of a proposal must reflect commercial and banking realities and should consist of the local area where customers can practicably turn for alternatives.⁶ In reviewing Community's contention, the Board has considered a number of factors to identify the economically integrated area that represents the appropriate local geographic banking market encompassing Cortez for purposes of analyzing the proposal's competitive effects.⁷

⁵ Community argues that approximately 7 percent of workers in Montezuma County, where Cortez is located, commute to La Plata County for employment, and that the absolute number of commuters traveling from Montezuma County to La Plata County exceeds the absolute number of commuters traveling to Montezuma County from Dolores County (the other county in the Cortez banking market). Community also notes that the only banking institution in Dolores County is 35 road miles from Cortez and that Durango, where most La Plata County banking institutions are located, is only 45 road miles from Cortez.

⁶ See United States v. Phillipsburg National Bank, 399 U.S. 350 (1970); United States v. Philadelphia National Bank, 374 U.S. 321, 357 (1963); Brown Shoe Co. v. United States, 370 U.S. 294, 336-337 (1962). See also First York Ban Corp, 88 Federal Reserve Bulletin 251 (2002); First Union Corporation, 84 Federal Reserve Bulletin 489 (1998); First Union Corporation, 83 Federal Reserve Bulletin 1012, 1013-14 (1997); Chemical Banking Corporation, 82 Federal Reserve Bulletin 239, 241 (1996); and Wyoming Bancorporation, 68 Federal Reserve Bulletin 313, 314 (1982).

⁷ In delineating the relevant geographic market in which to assess the competitive effects of a bank merger or acquisition, the Board reviews population density; worker commuting patterns; the usage and availability of banking products; advertising patterns of financial institutions; the presence of shopping, employment, and other necessities; and other indicia of economic integration and transmission of competitive forces

The Board reviewed the proximity of Cortez and Durango and the commuting data between their respective counties. A mountain pass between Cortez and Durango reportedly makes commuting and other travel between these cities difficult at times during the winter months. The rate of commuting between Montezuma and La Plata Counties remains low at approximately 7 percent of residents despite some increase during the past decade. Other indicators of economic integration, such as entertainment, restaurant, and shopping opportunities available in one market but not in the other, are insufficient to suggest that the low commuting rate understates the economic integration of the counties. Both cities have large discount retail stores and supermarkets.

Banking data also support the Reserve Bank's definition of the Cortez banking market as the relevant geographic market. Interviews by the Reserve Bank with bankers in Cortez and Durango indicate that most, if not all, of the local banks view the two cities as separate markets. Banks in each city generally have few customers from the other city, do not solicit or advertise for business in the other city, and do not monitor the loan or deposit rates of banks in the other city.⁸

Based on the foregoing and a careful review of all the facts of record, including information provided by local banks, the State of Colorado, and other publicly available information, the Board reaffirms that the relevant geographic market within which to evaluate the competitive effects of this proposal is the Cortez banking market, as currently defined by the Reserve Bank.

among banks. See, e.g., First Security Corporation, 86 Federal Reserve Bulletin 122 (2000); Pennbancorp, 69 Federal Reserve Bulletin 548 (1983).

⁸ One exception is a bank in the town of Mancos, Colorado, that has attracted depositors from both cities. Mancos is in Montezuma County between Cortez and Durango.

B. Competitive Effects in the Banking Market

The Board has reviewed carefully the competitive effects of the proposal in the Cortez banking market in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking market, the relative shares of total deposits in depository institutions in the market (“market deposits”) controlled by Community and Citizens,⁹ the concentration level of market deposits and the increase in this level as measured by the Herfindahl-Hirschman Index (“HHI”) under the Department of Justice Merger Guidelines (“DOJ Guidelines”),¹⁰ and other characteristics of the market.

In the Cortez banking market, the concentration levels on consummation of the proposal would exceed the threshold levels in the DOJ Guidelines. Community’s subsidiary, Community Bank, is the fifth largest depository institution in the market, controlling deposits of approximately \$51.8 million, which represent approximately 13.4 percent of market deposits. Citizens’ subsidiary, Citizens State Bank, is the third largest depository

⁹ Deposit and market share data are as of June 30, 2006, adjusted to reflect subsequent mergers and acquisitions through February 12, 2007. No savings associations operate in the market.

¹⁰ Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice (“DOJ”) has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

institution in the market, controlling deposits of approximately \$65.1 million, which represent approximately 16.8 percent of market deposits. On consummation of the proposal, Community Bank would become the largest depository institution in the market, controlling deposits of approximately \$116.9 million, which would represent 30.2 percent of market deposits. The HHI would increase 449 points to 2192.

The Board has considered carefully whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the market. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase in and the resulting level of concentration in a banking market.¹¹

Several factors indicate that the increase in concentration in the Cortez banking market, as measured by increases in the HHI and Community Bank's market share, overstates the potential competitive effects of the proposal. After consummation, five insured depository institutions would continue to operate in the market, which is an average number of competitors for sparsely populated rural banking markets like the Cortez market. The relative share of market deposits held by each depository institution indicates there is active competition in the market. Each of the four remaining institutions that directly compete with Community Bank will have a market share of between 12 percent and 22 percent on consummation of the proposal. Moreover, the market concentration as measured by the HHI has decreased by 624 points during

¹¹ See NationsBank Corp., 84 Federal Reserve Bulletin 129 (1998).

the last decade, from 2367 in 1996¹² to 1743 in 2006, evidencing significant and effective competition by market participants during this period.

In addition, actions by competitors to enter the market in 2007 demonstrate that the market is attractive for entry. Although no depository institutions have entered the market in recent years, two institutions have taken steps within the past year that will lead to entry into the market in 2007 through de novo branches. One bank established a loan production office (“LPO”) in Cortez in 2006 and has purchased a building as part of its plans to convert the LPO into a full-service branch in 2007. Another bank plans to open a de novo branch in the market in the near future and has taken significant actions to implement that plan. The Board previously has considered such prospective entry into a market by competitors as evidence of a market’s attractiveness for entry.¹³

C. Views of Other Agencies/Conclusion on Competitive Considerations

The DOJ also conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the proposal would not likely have a significantly adverse effect on competition in the Cortez banking market. In addition, the appropriate banking agencies were afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in the Cortez banking market or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

¹² Aspen Bancshares, Inc., 82 Federal Reserve Bulletin 665 (1996).

¹³ Southern National Corp., 83 Federal Reserve Bulletin 597 (1997).

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors.

The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by Community.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved both on a parent-only and on a consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial factors of the proposal. Community, all its subsidiary depository institutions, and Citizens Bank currently are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board also finds that Community has sufficient financial resources to effect the proposal. The

proposed transaction is structured as a cash purchase. The purchase would be funded from the proceeds of an issuance of trust preferred securities and debt.

The Board also has considered the managerial resources of Community, Citizens, and their subsidiary depository institutions. The Board has reviewed the examination records of these institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking laws, including anti-money laundering laws. The Board also has considered Community's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").¹⁴ Community Banks of Northern California and Community Bank both received "satisfactory" ratings at their most recent CRA performance evaluations by

¹⁴ 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

the Federal Reserve Bank of San Francisco and the Reserve Bank, as of November 17, 2003, and June 6, 2005, respectively. Citizens State Bank received a “satisfactory” rating at its most recent CRA performance evaluation by the Reserve Bank, as of September 5, 2006. After consummation of the proposal, Community plans to implement its CRA policies at Citizens State Bank. Community has represented that the proposal will provide greater convenience to customers through a larger network of branches and automated teller machines and a broader range of financial products and services over an expanded geographic area. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs of the community to be served and the CRA performance records of the relevant depository institutions are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board’s approval is specifically conditioned on compliance by Community with the conditions imposed in this order and the commitments made to the Board in connection with the application. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Reserve Bank, acting pursuant to delegated authority.

By order of the Board of Governors,¹⁵ effective March 1, 2007.

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

¹⁵ Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, and Kroszner. Absent and not voting: Governor Mishkin.