TEAM FINANCIAL INC /KS
Form 10-K405
March 29, 2002

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2001

Commission File Number: 000-26335

TEAM FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

KANSAS	**48-1017164**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

8 West Peoria, Suite 200, Paola, Kansas, 66071
(Address of principal executive offices) (Zip Code)

Registrant s telephone, including area code: **(913) 294-9667**

Securities registered pursuant to Section 12(g) of the Act:

Common stock, no par value

(Title of class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulations S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

The aggregate market value of the voting stock held by non-affiliates of the registrant, based on a March 6, 2002 closing price of $8.81 as reported on the NASDAQ National Market, was $20,450,970.

There were 4,179,242 shares of the Registrant s common stock, no par value, outstanding as of March 6, 2002.

DOCUMENTS TO BE INCORPORATED BY REFERENCE

Portions of Registrant s definitive proxy statement for its 2002 Annual Meeting of Shareholders to be filed within 120 days of December 31, 2001, will be incorporated by reference into Part III of this Form 10-K

PART I

Item 1. Business

General Description

Team Financial, Inc. (the Company) is a financial holding company incorporated in the State of Kansas. Its common stock is listed on the Nasdaq National Market (NASDAQ) under the symbol TFIN .

The Company offers full service community banking and financial services through 20 locations in the Kansas City metropolitan area, southeastern Kansas, western Missouri, the Omaha, Nebraska metropolitan area, and in Colorado Springs, Colorado. The Company s presence in Kansas consists of six locations in the Kansas City metro area, which includes the growth market of Johnson County, four locations in southeast Kansas and two locations along the I-70 corridor. The Company operates two locations in western Missouri, five in the growing metropolitan area of Omaha, Nebraska, and one in the growth market of Colorado Springs, Colorado.

The Company was formed in 1986. Since its formation, the Company has grown from $85 million in assets to $650 million in assets as of December 31, 2001. This growth was achieved through a combination of bank and branch acquisitions, the establishment of new branches, and by internal growth.

In mid 1999, the Company s common stock began trading on NASDAQ upon completion of a public offering in which the Company and the ESOP sold 850,000 and 300,000 shares, respectively of common stock at $11.25 per share.

The ESOP owned 28.2% of the Company s outstanding common stock as of December 31, 2001. Management believes that the ESOP reflects the Company s corporate culture that employees are the integral component of a financial institution. Management intends to continue the ESOP, as it is a significant incentive to attract and retain qualified employees.

During the quarter ended March 31, 2000, the Company acquired Fort Calhoun Investment Co., and its subsidiary Fort Calhoun State Bank with total assets of approximately $22.0 million. The acquisition compliments the Company s presence in the Omaha, Nebraska metropolitan area.

On September 18, 2001, the Company acquired 100% if the outstanding stock of Post Bancorp, Inc., owner of Colorado Springs National Bank for $12.8 million, consisting of $11.0 million in cash and $1.8 million in common stock. The Company financed the cash portion of the Post Bancorp, Inc. purchase price through the issuance of 1,552,500, 9.50% Cumulative Trust Preferred Securities at $10 per preferred security. The net proceeds were $14,425,000 after deduction of offering expenses and underwriting commissions of $1,100,000. The remaining net proceeds were be used to pay down the Company s line of credit. The cumulative trust preferred securities trade on the NASDAQ national market under the symbol TFINP .

On February 7, 2002 the Company s wholly owned subsidiary, Community Bank signed a purchase and assumption agreement for the sale of its Chapman and Abilene, Kansas branch locations to First National Bank of Belleville, Kansas. The purchase is expected to be finalized in the second quarter of 2002 pending regulatory approval. The funds received from the sale of the Community Bank branches will be re-invested in the growth areas of the Kansas City metropolitan market and in the Colorado Springs metropolitan market along the front range of the Colorado Rocky Mountains.

The Company serves the needs and caters to the economic strengths of the local communities in which it operates and strives to provide a high level of personal and professional customer service. The Company offers a variety of financial services to its retail and commercial banking customers. These services include personal and corporate banking services, trusts and estate planning, personal investment financial counseling services.

The Company s full complement of lending services include:

- a broad array of residential mortgage products, both fixed and adjustable rate

- consumer loans, including home equity lines of credit, auto loans, recreational vehicle, and other secured and unsecured loans
- specialized financing programs to support community development
- mortgages for multi-family real estate
- commercial real estate loans
- commercial loans to businesses, including revolving lines of credit and term loans
- construction lending
- agricultural lending

The Company also provides a broad selection of deposit instruments. These include:

- multiple checking and NOW accounts for both personal and business accounts
- various savings accounts, including those for minors
- money market accounts
- tax qualified deposit accounts such as Individual Retirement Accounts
- a broad array of certificate of deposit products

The Company also supports its customers by providing services such as:

- functioning as a federal tax depository
- providing access to merchant bankcard services
- supplying various forms of electronic funds transfer
- providing debit cards and credit cards
- providing telephone banking.

Through its trust and estate planning and its personal investment financial counseling services, the Company offers a wide variety of mutual funds, equity investments, and fixed and variable annuities.

The Company participates in the wholesale capital markets through the management of its security portfolio and its use of various forms of wholesale funding. The Company s security portfolio contains a variety of instruments, including callable debentures, taxable and non-taxable debentures, fixed and adjustable rate mortgage backed securities, and collateralized mortgage obligations.

The Company s results of operations depend primarily on net interest income, which is the difference between interest income from interest-earning assets and interest expense on interest-bearing liabilities. The Company s operations are also affected by non-interest income, such as service charges, loan fees, and gains and losses from the sale of newly originated loans. The Company s principal operating expenses, aside from interest expense, consist of compensation and employee benefits, occupancy costs, data processing expense and provisions for loan losses.

Competition

The Company faces a high degree of competition. In its market areas, there are numerous small banks and several larger national and regional financial banking groups such as United Missouri Bank and U.S. Bank. The Company also competes with insurance companies, savings and loan associations, credit unions, leasing companies, mortgage companies, and other financial service providers. Many of the banks and other financial institutions with which the Company competes have capital resources and legal lending limits substantially in excess of the capital resources and legal lending limits of the Company.

The Company competes for loans and deposits principally based on the availability and quality of services provided, responsiveness to customers, interest rates, loan fees and office locations. The Company actively solicits deposit customers and competes by offering them high quality customer service and a complete product line. The Company believes its personalized customer service, broad product line and banking franchise enable it to compete effectively in its market area.

In order to compete with other financial service providers, the Company relies upon local community involvement, personal service, and the resulting personal relationships of its staff and customers, and the development and sale of specialized products and services tailored to meet its customers needs.

The Company faces competition for its personnel. The Company competes through its emphasis as a community banking culture and through the use of its ESOP. Management believes that the Company is able to compete for personnel effectively in the Company s market areas because the ESOP provides incentives for employees to join the Company and motivation to enhance shareholder value.

The Company will also face significant competition from other financial institutions in any potential acquisitions. Many of these competitors have substantially greater resources than the Company.

The Company has three wholly owned bank subsidiaries. The table below presents information concerning these subsidiaries.

Name of Bank	**Number of Banking Locations**	**Lending Limit**	**Asset Size at December 31, 2001**
		(In Millions)	
TeamBank, N.A. Paola, Kansas a national banking association	17	$ 6.1	$ 522
Colorado Springs National Bank Colorado Springs, Colorado, a national banking association	1	1.1	86
Community Bank (1) Prairie Village, Kansas, a Kansas state chartered bank	2	0.9	41

(1) On February 7, 2002, the Company s wholly owned subsidiary, Community Bank signed a purchase and assumption agreement for the sale of its two branches.

Market Area Served

TeamBank, N.A. TeamBank, N.A. has banking locations in Kansas, Missouri, and Nebraska. TeamBank, N.A. s primary Kansas service area is in Miami County, Kansas. Located in the Kansas City metropolitan area, Miami County adjoins Johnson County, Kansas.

TeamBank, N.A. s Miami County branches are located in Paola, the county seat of Miami County, and Osawatomie, the second largest city in the county. TeamBank, N.A. also operates a branch in Ottawa, Kansas the county seat of the adjoining Franklin County, Iola Kansas; the county seat of Allen County; and operates two branches in Parsons, Kansas of Labette County. TeamBank, N.A. operates three branches in Johnson County, Kansas. TeamBank, N.A. s primary Missouri service area is in Barton and Vernon counties, which adjoin each other and are located in the southwest section of Missouri along the Kansas-Missouri border. TeamBank, N.A. also operates five facilities in the Omaha, Nebraska metropolitan area. The primary Nebraska service area is in Washington, Douglas, and Sarpy Counties.

Community Bank. Community Bank has two banking locations in Kansas. Community Bank s primary service area is Dickinson County, Kansas along the I-70 corridor. On February 7, 2002, Community Bank completed a purchase and assumption agreement for the sale these branch locations. The sale is expected to be finalized in the second quarter of 2002 pending regulatory approval. The remaining Community Bank charter will be merged into TeamBank, N.A.

Colorado Springs National Bank. Colorado Springs National Bank has one banking location in Colorado Springs, Colorado. The primary service areas are El Paso County and Teller County along the front range of the Colorado Rocky Mountains.

Growth and Operating Strategies

The Company s growth strategy is focused on a combination of acquisitions, existing branch growth and establishing new branches.

Acquisitions. Management believes that the consolidation in the banking industry, along with the easing of branch banking throughout Kansas, Missouri, Nebraska, Colorado, Oklahoma and Iowa, as well as increased regulatory burdens, concerns about technology and marketing, are likely to lead owners of community banks within these areas to explore the possibility of sale or combination with a broader-based holding company such as the Company.

In addition, branching opportunities have arisen from time to time as a result of divestiture of branches by large national and regional bank holding companies of certain overlapping branches resulting from consolidations. As a result, branch locations have become available for purchase. The Company completed three branch acquisitions and three bank holding company acquisitions from 1997 through 2001. See note 15 to the Consolidated Financial Statements in Item 8.

Management s strategy in assimilating acquisitions is to emphasize revenue growth as well as continuously review the operations of the acquired entities and streamline operations where feasible. Management does not believe that implementing wholesale administrative cost reductions in acquired institutions are beneficial to the Company s long-term growth, because significant administrative changes in smaller banks can have an adverse impact on customer satisfaction in the acquired institution s community. However, management has determined that certain processing and accounting functions can be consolidated immediately upon acquisition to achieve higher productivity levels without compromising customer service. Increases in revenue growth are emphasized by offering customers a broader product line consistent with full service banking.

Branch Expansion. Since 1994, the Company has established three new branches. Because of the economic growth in the Omaha, Nebraska area, the Colorado Springs, Colorado area, as well as Johnson County, Kansas, over the past several years, management may consider branch expansion in these areas. However, the Company does not rule out branch expansion in other areas experiencing economic growth.

The Company has considered and intends to consider a variety of criteria when evaluating potential acquisition candidates or branching opportunities. These include:

the geographic market location of the potential acquisition target or branch and demographics of the surrounding community;

the financial soundness of a potential acquisition target;

opportunities to improve the efficiency and/or asset quality of an acquisition target through merger;

the effect of the acquisition on earnings per share and book value. The Company seeks to undertake acquisitions that will be accretive to earnings within 18 months of the acquisition;

whether the Company has sufficient management and other resources to integrate or add the operations of the target or branch; and

the investment required for, and opportunity costs of, the acquisition or branch.

Internal Growth. The Company believes that its largest source of internal growth is through its ongoing solicitation program conducted by bank presidents and lending officers, followed by referrals from customers. The primary reason for referrals is positive customer feedback regarding the Company s customer service and response time.

The Company s goal in continuing its expansion is to maintain a profitable, customer-focused financial institution. The Company believes that its existing structure, management, data and operational systems are sufficient to achieve further internal growth in asset size, revenues and capital without proportionate increases in operating costs. This growth should also allow the Company to increase the lending limits of its banks, thereby enabling it to increase its ability to serve the needs of existing and new customers. The Company s operating strategy has always been to provide high quality community banking services to its customers and increase market share through active solicitation of new business, repeat business and referrals from customers, and continuation of selected promotional strategies.

For the most part, the Company s banking customers seek a banking relationship with a service-oriented community banking organization. The Company s operational systems have been designed to facilitate personalized service. Management believes its banking locations have an atmosphere which facilitates personalized services and decision-making, yet are of sufficient financial size with broad product lines to meet customers needs. Management also believes that economic expansion in the Company s market areas will continue to contribute to internal growth. Through the Company s primary emphasis on customer service and its management s banking experience, the Company intends to continue internal growth by attracting customers and primarily focusing on the following:

Products Offered The Company offers personal and corporate banking services, trusts and estate planning, mortgage origination, mortgage servicing, personal investment, and financial counseling services as well as telephone banking. It offers a full range of commercial banking services, checking accounts, ATM s, checking accounts with interest, savings accounts, money market accounts, certificates of deposit, NOW accounts, Individual Retirement Accounts, brokerage and residential mortgage services, branch banking, and Team Financial Visa debit cards and Visa/MC credit cards. The Company also offers installment loans, including auto, recreational vehicle, and other secured and unsecured loans sourced directly by its branches. See Loans below for a discussion of products the Company provides to commercial accounts.

Operational Efficiencies The Company seeks to maximize operational and support efficiencies consistent with maintaining high quality customer service. Where feasible, the Company s banks share a common information system designed to enhance customer service and improve efficiencies by providing system-wide voice and data communication connections. The Company has consolidated loan processing, bank balancing, financial reporting, investment management, information systems, payroll and benefit management, loan review, and audits.

Marketing Activities The Company focuses on an active solicitation program for new business, as well as identifying and developing products and services that satisfy customer needs. The Company s marketing programs also utilize local print and promotional materials in each location. The Company also actively sponsors community events within its branch areas. The Company believes that active community involvement contributes to its long-term success.

Loans

The Company provides a broad range of commercial and retail lending services. Each of the Company s banks follow a uniform credit policy which contains underwriting and loan administration criteria, levels of loan commitment, loan types, credit criteria, concentration limits, loan administration, loan review and grading and related matters. In addition, the Company provides ongoing loan officer training and review, obtains outside independent loan reviews and operates a centralized processing and servicing center for loans. At December 31, 2001, substantially all loans outstanding were to customers within the Company s market areas.

Loan Administration. The Company maintains a loan committee approach to lending, which it believes yields positive results in both responsiveness to customer needs and asset quality. Each of the Company s subsidiary banks and some branches have a loan committee, which meets at least once per week to review and discuss loans. Each bank and some branches also have a loan level threshold, which, if exceeded, requires the approval of the Company s loan committee, which meets on an on-call basis. Loans greater than $2.5 million require the approval of the Company s board of directors.

Interest rates charged on loans vary with the degree of risk, maturity, costs of underwriting and servicing, loan amount, and extent of other banking relationships maintained with customers, and are further subject to competitive pressures, availability of funds and government regulations.

Real Estate Loans. These loans include various types of loans for which the Company holds real property as collateral. Interest rates on these loans typically adjust annually. Real estate construction loans include commercial and residential real estate construction loans, but are principally made to builders to construct business buildings or single and multi-family residences. Real estate construction loans typically have maturities of six to 12 months, and charge origination fees. Terms may vary depending upon many factors, including location, type of project and financial condition of the borrower. It is the Company s standard practice in making commercial loans to receive real estate as collateral in addition to other appropriate collateral. Therefore, loans categorized in the other real estate loan category can be characterized as commercial loans, which are secured by real estate. Commercial loans secured by real estate typically have adjustable interest rates. The primary risks of real estate mortgage loans include the borrower s inability to pay and deterioration in value of real estate that is held as collateral.

Commercial Loans. These loans consist primarily of loans to businesses for various purposes, including revolving lines of credit and equipment financing. The loans secured by collateral other than real estate, generally mature within one year, have adjustable interest rates and are secured by inventory, accounts receivable, machinery, government guarantees, or other commercial assets. Revolving lines of credit are generally for business purposes, mature annually and have adjustable interest rates. The primary repayment risk of commercial loans is the failure of the borrower s business due to economic or financial factors.

Agricultural Loans. The Company makes a variety of agricultural loans which are included in real estate and commercial loans. These loans relate to equipment, livestock, crops and farmland. The primary risks of agricultural loans include the prices of crops and livestock, as well as weather conditions.

Installment Loans. Installment loans are primarily to individuals, are typically secured by the financed assets, generally have terms of two to five years and bear interest at fixed rates. These loans usually are secured by motor vehicles or other personal assets and in some instances are unsecured. The primary risk of consumer lending relates to the personal circumstances of the borrower.

Letters of Credit

In the ordinary course of business, the Company issues letters of credit. See note 16 to Item 8 - Financial Statements. The Company applies the same credit standards to these commitments as it uses in all its lending activities and has included these commitments in its lending risk evaluations. The Company s exposure to credit loss under letters of credit is represented by the amount of these commitments.

Employees

As of December 31, 2001, the Company had approximately 264 full-time equivalent employees. Neither the Company nor any of its subsidiaries is a party to any collective bargaining agreement. Management considers the Company s relationship with its employees to be good.

Principal Sources of Revenue

The Company s results of operations depend primarily on net interest income, which is the difference between interest income from interest-earning assets and interest expense on interest-bearing liabilities. The Company s operations are also affected by non-interest income, such as service charges, loan fees, and gains and losses from the sale of newly originated loans. The Company s principal operating expenses, aside from interest expense, consist of compensation and employee benefits, occupancy costs, data processing expense and provisions for loan losses.

Supervision and Regulation

Government Regulation

The Company and its banks are extensively regulated under federal and Kansas law. These laws and regulations are primarily intended to protect depositors and the deposit insurance fund of the Federal Deposit Insurance Corporation, not shareholders of the Company. The following information is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in applicable laws, regulations or regulatory policies may have a material effect on the business, operations and prospects of the Company and its banks. The Company is unable to predict the nature or extent of the effects that fiscal or monetary policies, economic controls or new federal or state legislation may have on its business and earnings in the future.

The Company

General. The Company operates as a financial holding company registered under the Gramm-Leach-Bliley Act (GLBA). This law permits former bank holding companies that have registered as financial holding companies to affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The Company intends to diversify into financial activities, such as insurance.

No regulatory approval is required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. The GLBA defines financial in nature to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Board has determined to be closely related to banking. A national bank also may engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting, insurance company portfolio investment, real estate development and real estate investment, through a financial subsidiary of the bank, if the bank is well capitalized, well managed and has at least a satisfactory Community Reinvestment Act (CRA) rating.

Although it preserves the Federal Reserve as the umbrella supervisor of financial holding companies, the GLBA defers the administration of the non-banking activities to the customary regulators of insurers, broker-dealers, investment companies and banks. Thus, the various state and federal regulators of a financial holding company s operating subsidiaries would retain their jurisdiction and authority over such operating entities. As the umbrella supervisor, however, the Federal Reserve has the potential to affect the operations and activities of financial holding companies subsidiaries through its power over the financial holding company parent. The GLBA contains restrictions on financial institutions regarding the sharing of customer nonpublic personal information with non-affiliated third parties unless the customer has had an opportunity to opt out of the disclosure. The GLBA also imposes periodic disclosure requirements concerning a financial institution s policies and practices regarding data sharing with affiliated and non-affiliated parties.

Subsidiary banks of a financial holding company or national banks with financial subsidiaries must continue to be well capitalized and well managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions, which could include divestiture of the financial in nature subsidiary or subsidiaries. In addition, a financial holding company or a bank may not acquire a company that is engaged in activities that are financial in nature unless each of the subsidiary banks of the financial holding company or the bank has CRA rating of satisfactory or better.

Acquisitions. As a financial holding company, the Company is required to obtain the prior approval of the Federal Reserve before acquiring direct or indirect ownership or control of more than 5% of the voting shares of a bank or financial holding company. The Federal Reserve will not approve any acquisition, merger or consolidation that would have a substantial anti-competitive effect, unless the anti-competitive effects of the proposed transaction are outweighed by a greater public interest in meeting the needs and convenience of the community. The Federal Reserve also considers managerial resources, current and projected capital positions and other financial factors in acting on acquisition or merger applications.

Capital Adequacy. The Federal Reserve monitors the regulatory capital adequacy of financial holding companies. As discussed below, the Company s banks are also subject to the regulatory capital adequacy requirements of the Federal Deposit Insurance Corporation, the Comptroller of the Currency, Kansas and Nebraska regulations, as applicable. The Federal Reserve uses a combination of risk-based guidelines and leverage ratios to evaluate the regulatory capital adequacy of the Company.

The Federal Reserve has adopted a system using risk-based capital adequacy guidelines to evaluate the regulatory capital adequacy of financial holding companies. The guidelines apply on a consolidated basis to financial holding companies with consolidated assets of at least $150 million. Under the risk-based capital guidelines, different categories of assets are assigned to different risk categories based generally on the perceived credit risk of the asset. The risk weights of the particular category are multiplied by the corresponding asset balances and added together to determine a risk-weighted asset base. Some off balance sheet items, such as loan commitments in excess of one year, mortgage loans sold with recourse and letters of credit, are added to the risk weighted asset base by converting them to a credit equivalent and assigning them to the appropriate risk category. For purposes of the Federal Reserve s regulatory risk based capital guidelines, total capital is defined as the sum of core and secondary capital elements, with secondary capital being limited to 100% of core capital. For financial holding companies, core capital, also known as Tier 1 capital, generally includes common shareholders equity, perpetual preferred stock and minority interests in consolidated subsidiaries, less goodwill and other intangible assets. No more than 25% of core capital elements may consist of cumulative preferred stock. Secondary capital, also known as Tier 2 capital, generally includes the allowance for loan losses limited to 1.25% of weighted risk assets, certain forms of perpetual preferred stock, as well as hybrid capital instruments. The Federal Reserve s regulatory guidelines require a minimum ratio of qualifying total capital to weighted risk assets of 8%, of which at least 4% should be in the form of core capital. At December 31, 2001, the Company s core capital was $41.6 million.

In addition to the risk-based capital guidelines, the Federal Reserve, the Federal Deposit Insurance Corporation and the Comptroller of the Currency use a leverage ratio as an additional tool to evaluate capital adequacy. The leverage ratio is defined by the Federal Reserve to be a company s core capital divided by its average total consolidated assets, and the Comptroller of the Currency s and Federal Deposit Insurance Corporation s definitions are similar. Based upon the current capital status of the Company, the applicable minimum required leverage ratio is 4%.

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The table below presents the Company s ratios of (1) total capital to risk-weighted assets, (2) core capital to risk weighted assets and (3) core capital to average assets, at December 31, 2001.

Ratio	At December 31, 2001	
	Actual	Minimum Required
Total capital to risk weighted assets	11.72%	8.00%
Core capital to risk weighted assets	10.60%	4.00%
Core capital to average assets	6.92%	4.00%

Failure to meet the regulatory capital guidelines may result in the initiation by the Federal Reserve of appropriate supervisory or enforcement actions, including but not limited to delaying or denying pending or futures applications to acquire additional financial or bank holding companies.

The Banks

General. The Company owns two national chartered banks and one state chartered bank. TeamBank, N.A. and Colorado Springs National Bank, as national banks, are subject to regulations by the Office of the Comptroller of the Currency. Community Bank is regulated by the Kansas Office of the State Bank Commissioner and is subject to supervision and regulations by the Federal Deposit Insurance Corporation. The deposits of all of the banks are insured by the Federal Deposit Insurance Corporation.

Permissible Activities. A Kansas state chartered bank may not engage in any activity not permitted for national banks, unless the institution complies with applicable capital requirements and the Federal Deposit Insurance Corporation determines that the activity poses no significant risk to the Bank Insurance Fund. Community Bank is presently not involved in the types of transactions covered by this limitation.

Community Reinvestment Act. Enacted in 1977, the federal Community Reinvestment Act has become important to financial institutions, including their holding companies. Financial institutions have a continuing and affirmative obligation, consistent with safe and sound operations of such institutions, to serve the convenience and needs of the communities in which they are chartered to do business, including low- and moderate-income neighborhoods. The Community Reinvestment Act currently requires that regulators consider an applicant s Community Reinvestment Act record when evaluating certain applications, including charters, branches and relocations, as well as mergers and consolidations. The applicable federal regulators regularly conduct Community Reinvestment Act examinations to assess the performance of financial institutions and assign one of four ratings to the institution s records of meeting the credit needs of its community. During their last examinations, ratings of at least satisfactory were received by all of the Company s banks. As a result, management believes that the performance of the Company s banks under the Community Reinvestment Act will not impede regulatory approvals of any proposed acquisitions or branching opportunities.

Dividend Restrictions. Dividends paid by the Company s banks provide a substantial amount of the operating and investing cash flow of the Company. Under Kansas law, the current dividends can be paid only from undivided profits after deducting losses, but before declaring dividends a bank must transfer 25% of its net profits since the last preceding dividend to its surplus fund until the surplus fund equals the total capital stock.

With respect to national banks, the directors of any such bank may quarterly, semiannually, or annually declare a dividends of so much of the bank s undivided profits as they deem expedient, except until the bank s surplus fund equals its common capital at which time, no dividends may be declared unless the bank has carried to the surplus fund at least one-tenth of the bank s net income of the preceding half year in the case of quarterly or semiannual dividends, or at least one-tenth of its net income of the preceding two consecutive half-year periods in the case of annual dividends. However, the Comptroller of the Currency s approval is required if the total of all dividends declared by a bank in any calendar year exceeds the total of its net income of that year combined with its retained net income of the preceding two years, less any required transfers to surplus or a fund for the retirement of any preferred stock.

Examinations. The Company s banks are examined from time to time by their primary federal banking regulators. Based upon an evaluation, the examining regulator may revalue a bank s assets and require that it establish specific reserves to compensate for the difference between the value determined by the regulator and the book value of the assets. The Kansas Office of the State Bank Commissioner also conducts examinations of state-chartered banks. The Kansas regulators may accept the results of a federal examination in lieu of conducting an independent examination. Kansas regulators have the authority to revalue the assets of a state-chartered institution and require it to establish reserves.

Capital Adequacy. The Federal Deposit Insurance Corporation and the Comptroller of the Currency have adopted regulations establishing minimum requirements for the capital adequacy of insured institutions. The requirements address both risk based capital and leverage capital, with risk-based assets and core and secondary capital being determined in basically the same manner as described above for financial holding companies. The Federal Deposit Insurance Corporation or the Comptroller of the Currency may establish higher minimum requirements if, for example, a bank has previously received special attention or has a high susceptibility to interest rate risk.

The Federal Deposit Insurance Corporation risk-based capital guidelines require state non-member banks and national banks to have a ratio of total capital to total risk-weighted assets of 8%, of which total capital at least 4% should be in the form of core capital.

The table below presents the regulatory capital ratios of Community Bank at December 31, 2001.

	At December 31, 2001
	Community Bank
Ratio	**Actual**