960,000 Shares
BREMER FINANCIAL CORPORATION

Class A Common Stock

Minimum Purchase: 50 Shares ($562)
Maximum Purchase: 60,000 Shares ($674,400)

Otto Bremer Foundation (the "Foundation"), a private charitable trust established for charitable, educational, and religious purposes, is offering 960,000 shares of the Class A Common Stock, no par value (the "Class A Common Stock"), of Bremer Financial Corporation (the "Company") in this offering on a best efforts basis in connection with the Company's Plan of Reorganization between the Company and the Foundation (the "Plan of Reorganization"). The Plan of Reorganization has been adopted to enable the Foundation to meet its divestiture obligations under Section 4943 of the Internal Revenue Code of 1986, as amended (the "Code"). See "Plan of Reorganization." Shares of Common Stock are offered hereby (i) directly to employees and directors of the Company, its twenty-five subsidiary banks (the "Subsidiary Banks"), and the Company's financial service subsidiaries; (ii) to the Company's Employee Stock Ownership Plan; and (iii) to employees of the Company, the Subsidiary Banks, and the Company's financial service subsidiaries through the Bremer Banks Profit Sharing Plus Plan. There is no underwriter in connection with this offering. The offering is made by the Foundation through certain officers of the Company and the Subsidiary Banks (without compensation therefor) where permitted by law or, if required by applicable state law, through a registered broker-dealer. The minimum purchase in this offering for each investor is 50 shares of Class A Common Stock and the maximum purchase is 60,000 shares, which is equal to 5% of the outstanding shares of Class A Common Stock. In addition, all purchases will be subject to certain other terms and conditions, including the Foundation's right to reject orders in whole or in part in its sole discretion. See "Plan of Distribution."

All of the shares of Class A Common Stock offered hereby are being sold by the Foundation. There is no market for the Class A Common Stock of the Company, and an active market is not expected to develop after this offering, as the later sale and other transfer of the Class A Common Stock offered hereby will be restricted and the stock certificates evidencing the Class A Common Stock will bear a legend setting forth such restrictions on transfer. See "Description of Capital Stock — Description of Class A Common Stock."

The Company, the Foundation, or their respective assignee or transferee will have an option to purchase shares of Class A Common Stock upon the occurrence of certain events, and the holders of such shares will be required to sell the shares upon the exercise of such option. In addition, the holders of shares of Class A Common Stock will have an option to require the Company, the Foundation, or their respective assignee or transferee to purchase such shares upon the occurrence of certain events. See "Special Considerations — Special Considerations Regarding an Investment in the Company" and "Description of Capital Stock — Description of Class A Common Stock."

The per share offering price of the Class A Common Stock is equal to its unaudited per share book value as of March 31, 1989, as determined by the Company's management. See "Plan of Distribution."

PROSPECTIVE INVESTORS SHOULD CAREFULLY CONSIDER THE SPECIAL CONSIDERATIONS AND THE RISK FACTORS DESCRIBED IN THIS PROSPECTUS. SEE "SPECIAL CONSIDERATIONS."

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to Public	Underwriting Discounts and Commissions	Proceeds to Foundation (1)
Per Share	$11.24	$0	$11.24
Total	$10,790,400	$0	$10,790,400

(1) Before deducting offering expenses payable by the Foundation, estimated at $340,000. See "Use of Proceeds."

The shares of Class A Common Stock are offered by the Foundation subject to its right to reject orders in whole or in part. It is expected that the offering will close and that delivery of the certificates for the shares will be made against payment therefor on or about May 15, 1989. If fewer than 960,000 shares of Class A Common Stock are sold in this offering on or before May 22, 1989, the Foundation may divest of shares by other methods, which may include donating shares of Class A Common Stock to various charities. See "Plan of Distribution."

The date of this Prospectus is April 20, 1989.

AVAILABLE INFORMATION

The Company is not currently subject to the reporting requirements of the Securities Exchange Act of 1934 but anticipates that following completion of this offering it will be required to file reports and other information with the Securities and Exchange Commission (the "Commission"). The Company intends to furnish to its shareholders annual reports containing financial information with respect to the Company that has been examined and reported upon with an opinion expressed by an independent certified public accountant and quarterly reports containing unaudited financial statements.

The Company has filed with the Commission a Registration Statement on Form S-1 under the Securities Act of 1933 with respect to the shares of Class A Common Stock offered hereby. This Prospectus does not contain all the information set forth in the Registration Statement, certain portions of which have been omitted as permitted by the rules and regulations of the Commission. For further information with respect to the Company, the Foundation, and the Class A Common Stock, reference is made to the Registration Statement, including the exhibits thereto. The Registration Statement may be examined at the offices of the Commission, 450 Fifth Street N.W., Washington, D.C. 20549, and at its regional offices located at Room 1102, Jacob K. Javits Federal Building, 26 Federal Plaza, New York, New York 10278; and Room 1204, Everett McKinley Dirksen Building, 219 South Dearborn Street, Chicago, Illinois 60604. Copies of the Registration Statement and the exhibits thereto may be obtained from the Public Reference Section of the Commission at its Washington, D.C. office upon payment of the prescribed fees.

PROSPECTUS SUMMARY

The following information is qualified in its entirety by the detailed information and financial statements, including the notes thereto, appearing elsewhere in this Prospectus.

The Company, the Foundation, and the Plan of Reorganization

The Company was incorporated in December 1943 as a Minnesota multi-state bank holding company under the name "Otto Bremer Company," with Mr. Otto Bremer as the only shareholder thereof. The Company changed its name from "Otto Bremer Company" to "Bremer Financial Corporation" on April 21, 1983. The Company owns 81% or more of the outstanding capital stock of the twenty-five Subsidiary Banks located in Minnesota, Wisconsin, and North Dakota. In addition, the Company owns all of the outstanding capital stock of five financial service subsidiaries engaged in various activities such as data processing and rendering insurance agency and trust services and owns a controlling portion of the capital stock of a captive insurance company. The operations of the financial service subsidiaries and the insurance company are not significant to the Company's operations, and the Company's principal asset is the capital stock of the Subsidiary Banks. See "Business — Financial Service Subsidiaries." The Foundation is a private foundation described in Section 509(a) of the Internal Revenue Code of 1986, as amended (the "Code"), formed by Mr. Otto Bremer under a trust agreement dated May 22, 1944. The Foundation owns and at all times since February 15, 1951 has owned all of the outstanding shares of capital stock of the Company. See "The Company and the Foundation."

The Foundation's holdings in the Company are subject to the private foundation excise taxes under Chapter 42 of the Code, including the tax on "excess business holdings" imposed by Section 4943 of the Code. Section 4943 of the Code was enacted by the Tax Reform Act of 1969 and generally requires private foundations to reduce their equity ownership of active business enterprises. In order to satisfy the divestiture requirements of Section 4943 of the Code applicable to the Foundation commencing May 26, 1989, the Foundation must reduce its holdings of the Company's capital stock. The trustees of the Foundation and management of the Company have determined that the most appropriate means of satisfying these divestiture requirements is pursuant to the Company's Plan of Reorganization (the "Plan of Reorganization"), which was entered into by the Company and the Foundation and adopted by the Company on February 8, 1989. See "Plan of Reorganization." Under the Plan of Reorganization, the Company's Articles of Incorporation were amended to authorize 12,000,000 shares of Class A Common Stock and 10,800,000 shares of no par value Class B Common Stock ("Class B Common Stock"). The Foundation received in exchange for its then-existing capital stock in the Company 10,800,000 shares of Class B Common Stock and 1,200,000 shares of Class A Common Stock, 960,000 of which are being sold in this offering. The shares of Class A Common Stock have full rights to vote on all matters properly before the Company's shareholders, including the election of the Company's directors. The Class B Common Stock is non-voting except with respect to certain extraordinary corporate transactions, such as a vote on a proposed merger, consolidation, liquidation, or dissolution of the Company or a proposed sale of all or substantially all of its assets or a proposed amendment to the Company's Articles of Incorporation that would change the Company's capital structure or change the voting power of the Class A Common Stock or the Class B Common Stock. The holders of Class B Common Stock would have the right to vote on an equivalent per share basis with the holders of the Class A Common Stock with respect to a vote on such transactions. In addition, each share of Class B Common Stock is convertible into one share of Class A Common Stock upon the occurrence of the following events: (i) at the affirmative election of the transferee, upon the transfer of Class B Common Stock from the Foundation to any third party or entity, or (ii) at the affirmative election of the holder of Class B Common Stock, if cash dividends have not been paid on the Class A Common Stock and the Class B Common Stock in any year (beginning in 1989) in an amount equal to at least 5% of the Company's consolidated net book value as of the last day of the immediately preceding fiscal year (beginning with 1988). See "Description of Capital Stock."

The Company or its assignee will have an option to buy a holder's shares of Class A Common Stock, and, upon exercise of such option, the holder will be obligated to sell such shares, upon a proposal by the holder to sell or otherwise transfer such shares in a voluntary or involuntary transfer, the death of a holder, or the retirement or termination of employment of a holder who is an employee of the Company or any of its subsidiaries. The Foundation, its assignee, or its transferee will have an option to buy shares of Class A Common Stock, and the holder of such shares would have an obligation to sell them upon the exercise of such option, if the Foundation sells all or substantially all of its shares of Class B Common Stock. In addition, and upon such sale, the holders of shares of Class A Common Stock will have the right to sell their shares to the Foundation or its transferee. See "Special Considerations — Special Considerations Regarding an Investment in the Company" and "Description of Capital Stock — Description of Class A Common Stock."

Upon completion of the divestiture of 960,000 shares of Class A Common Stock by the Foundation in this offering, the Foundation will own 20% of the outstanding shares of Class A Common Stock and therefore 20% of the voting power for matters to be voted on by the holders of Class A Common Stock. In addition, and upon any conversion of the Class A Common Stock held by the Foundation into Class B Common Stock, the Foundation would own 92% of the voting shares of the Company and would thus control the Company. See "Special Considerations — Special Considerations Regarding an Investment in the Company — Voting Control of Company."

The address of the Company and the Foundation is 55 East Fifth Street, Suite 700, St. Paul, Minnesota 55101, and their telephone number is (612) 227-7621.

Special Considerations

An investment in the Class A Common Stock involves special considerations and certain risks, including those inherent in the banking business that are not unique to the Company and also special considerations and risks associated with the Company and an investment in the Class A Common Stock. See "Special Considerations."

The Offering

Shares Offered	960,000 shares of Class A Common Stock.
Shares Outstanding	1,200,000 shares of Class A Common Stock and 10,800,000 shares of Class B Common Stock before and after this offering.
Use of Proceeds	Investment for the purpose of producing income, with the income being available for use for future grants by the Foundation. See "Use of Proceeds."

The Foundation is offering for sale hereby 960,000 shares of Class A Common Stock (i) directly to employees and directors of the Company, the Subsidiary Banks, and the Company's financial service subsidiaries; (ii) to the Company's Employee Stock Ownership Plan (the "ESOP"); and (iii) to employees of the Company, the Subsidiary Banks, and the Company's financial service subsidiaries through the Bremer Banks Profit Sharing Plus Plan (the "Profit Sharing Plan"). If the offering is oversubscribed, there may be restrictions on the maximum number of shares of Class A Common Stock that may be purchased in this offering by any investor based upon the total number of shares for which subscriptions are received; however, no individual investor may purchase in this offering more than 5% of the outstanding shares of Class A Common Stock (or 60,000 shares). The minimum purchase in this offering is 50 shares of Class A Common Stock. See "Plan of Distribution."

How to Purchase Shares

Shares of Class A Common Stock may be purchased in the offering by completing the Stock Order Form described, and following the instructions set forth, in the portion of this Prospectus entitled "Plan of Distribution."

Summary Financial Data

The financial data set forth below is summary financial data relating to the Company's financial condition and results of operations. Such data should be read in conjunction with, and is qualified in its entirety by reference to, the Consolidated Financial Statements and the discussion set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations" set forth elsewhere in this Prospectus.

Summary Financial Data

	For the Year Ended December 31,				
	1984	1985	1986	1987	1988
	(In thousands, except per share amounts and ratios)				
Income Statement Data:					
(Tax equivalent basis)					
Interest income	$ 170,706	$ 168,766	$ 157,428	$ 148,114	$ 154,213
Interest expense	103,643	97,914	86,735	76,990	82,314
Net interest income	67,063	70,852	70,693	71,124	71,899
Provision for loan losses	15,832	23,548	15,063	8,811	6,418
Net interest income after provision for loan losses	51,231	47,304	55,630	62,313	65,481
Noninterest income	10,521	19,718	24,445	19,234	18,141
Noninterest expense	49,552	54,095	57,860	59,316	59,666
Income before income tax expense	12,200	12,927	22,215	22,231	23,956
Income tax expense	6,962	6,849	11,181	9,542	9,082
Net income	$ 5,238	$ 6,078	$ 11,034	$ 12,689	$ 14,874
Other Data:					
Assets at end of period	$1,495,986	$1,560,521	$1,612,471	$1,624,046	$1,702,373
Shareholder's equity at end of period	100,858	104,436	112,470	121,359	132,333
Dividends paid to the Foundation as the sole shareholder	2,500	2,500	3,000	3,800	3,900
Book value per share at end of period (1)(2)	8.40	8.70	9.37	10.11	11.03
Earnings per share (1)(3)	0.44	0.51	0.92	1.06	1.24
Return on beginning equity (4)	5.34%	6.03%	10.57%	11.28%	12.26%
Dividends:					
Dividends per share (1)(5)	$0.21	$0.21	$0.25	$0.32	$0.33
Yield (6)	2.55%	2.48%	2.87%	3.38%	3.21%
Pay-out (7)	47.73	41.13	27.19	29.95	26.22

(1) All per share amounts have been restated to reflect the issuance of 12,000,000 shares of Class A and Class B Common Stock pursuant to the Plan of Reorganization.

(2) Consists of shareholder's equity at the end of the year indicated divided by the number of shares of capital stock deemed outstanding (12,000,000 shares of Class A Common Stock and Class B Common Stock).

(3) Consists of net income for the year indicated divided by the number of shares of capital stock deemed outstanding (12,000,000 shares of Class A Common Stock and Class B Common Stock).

(4) Consists of net income for the year indicated divided by shareholder's equity as of the last day of the preceding year.

(5) Consists of dividends paid during the year indicated divided by the number of shares of capital stock deemed outstanding (12,000,000 shares of Class A Common Stock and Class B Common Stock).

(6) Consists of dividends paid during the year indicated divided by shareholder's equity as of the last day of the preceding year.

(7) Consists of dividends paid during the year indicated divided by net income for the same year.

Book Value Per Share

The initial offering price of the Class A Common Stock is equal to the unaudited book value per share as of March 31, 1989, as determined by the Company's management. Management anticipates that any future trades of the Class A Common Stock will be at the then effective book value (with the possible exception of trades involving the ESOP). See "Description of Capital Stock — Description of Class A Common Stock." Book value per share is increased by earnings and reduced by dividends paid. The book value per share of the Company's outstanding capital stock (as adjusted to reflect the issuance of 12,000,000 shares of Class A Common Stock and Class B Common Stock pursuant to the Plan of Reorganization), which was $7.48 per share at December 31, 1982, increased to $10.11 per share at December 31, 1987, representing an annual compound growth rate of 6.3% over this five-year period. The Company's book value per share at December 31, 1988 was $11.03 (as adjusted to reflect the issuance of 12,000,000 shares of Class A Common Stock and Class B Common Stock), representing a $.92, or 9.1%, increase since December 31, 1987.

Return on Beginning Equity

The annual return on the Class A Common Stock will be equal to the Company's return on equity ("ROE"), which is equal to net income for the period considered divided by shareholder's equity at the beginning of such period. Shareholder's equity is increased by earnings and decreased by dividends paid to shareholders. The Company's annual compound growth rate of ROE over the five-year period from January 1, 1984 to December 31, 1988 was 9.1%. The ROE ranged from a low of 5.3% in the year ended December 31, 1984 and then steadily increased each year until it reached 12.3% for the year ended December 31, 1988.

Investment Return

The investment return on the Class A Common Stock will depend upon the following two components: one, the increase or decrease in book value per share of Class A Common Stock (that is, unrealized appreciation or depreciation) and two, the cash dividends paid. On a historical basis, if an investor had purchased capital stock of the Company on January 1, 1984 for a purchase price equal to book value, the total annual compound investment return for the five years ended December 31, 1988 would have been 9.1%, consisting of an unrealized gain of 6.2% (that is, the increase in book value from $8.18 per share at December 31, 1983 to $11.03 per share at December 31, 1988) and cash dividends paid of 2.9% (which is the amount of cumulative cash dividends paid during the five years ended December 31, 1988).

THE COMPANY AND THE FOUNDATION

The Company is a regional multi-state bank holding company incorporated in Minnesota under the name "Otto Bremer Company" on December 7, 1943, with Mr. Otto Bremer as the sole shareholder. The Company changed its name to Bremer Financial Corporation on April 21, 1983. The Foundation is a private foundation as described in Section 509(a) of the Code formed by Mr. Otto Bremer under a trust agreement dated May 22, 1944. It is organized as a trust for charitable, educational, and religious purposes for the benefit of persons, institutions, corporations, and municipalities, states, or their subdivisions who are residents of or have their situs in Minnesota, Wisconsin, North Dakota, or Montana. When the Foundation was formed, Mr. Otto Bremer transferred to it approximately 51% of the Company's capital stock. He transferred the remaining 49% of the Company's capital stock to the Foundation in two separate transfers on October 4, 1949 and February 15, 1951. Therefore, the Foundation owns and has owned since February 15, 1951 all of the issued and outstanding capital stock of the Company and therefore is, and is subject to regulation as, a bank holding company within the meaning of the Bank Holding Company Act of 1956. See "Supervision and Regulation." After completion of the offering, the Foundation will own 20% of the outstanding shares of Class A Common Stock, 100% of the outstanding shares of Class B Common Stock, and 92% of the outstanding shares of the Company's capital stock, consisting of Class A Common Stock and Class B Common Stock. See "Special Considerations — Special Considerations Regarding an Investment in the Company — Voting Control of the Company." The Trustees of the Foundation are Robert J. Reardon, William H. Lipschultz, and Gordon Shepard. See "Management." The Foundation had total assets of approximately $124 million and $135 million at December 31, 1987 and 1988, respectively.

The Company owns at least 81% of the outstanding capital stock of the twenty-five commercial Subsidiary Banks located in Minnesota, Wisconsin, and North Dakota. At December 31, 1988, the Company and its subsidiaries (including the Subsidiary Banks) had consolidated assets of approximately $1.7 billion, consolidated deposits of approximately $1.5 billion, and shareholder's equity of approximately $132 million.

The Subsidiary Banks range in size from $14.3 million to $221.1 million in total assets and from $12.6 million to $188.6 million in total deposits as of December 31, 1988. Each of them provides a full range of commercial and consumer banking services, including the acceptance of savings and checking deposits and the making of commercial, real estate, agricultural, personal and other installment and term loans. The Subsidiary Banks are located in predominantly rural communities with populations of approximately 400 to 179,000 people. See "Business — Subsidiary Banks." They are grouped into three regions, and each region is headed by a Region President who was or is a president of a Subsidiary Bank in his region. See "Business — Administration of Subsidiary Banks" and "Management." This allows the centralized and coordinated administration of the Subsidiary Banks by management that is familiar with each Subsidiary Bank's region but gives each Subsidiary Bank the opportunity to effectively serve its particular community. Each of the Subsidiary Banks is involved in community activities to develop and promote a strong relationship between the Subsidiary Bank and the community it serves. See "Business — Subsidiary Banks."

The Company also owns all of the outstanding capital stock of five financial service subsidiaries and owns a controlling portion of the capital stock of a captive insurance company. Bremer Financial Services, Inc. ("Bremer Financial"), a wholly-owned subsidiary of the Company, provides the management function for the Company and also provides support in numerous areas of bank policy and operations to the Subsidiary Banks and the other financial service subsidiaries. First American Information Services, Inc. ("First American Information") provides data processing and other operational support services to the Subsidiary Banks and is a wholly-owned subsidiary of the Company. First American Trust Company of Minnesota, which is also a wholly-owned subsidiary of the Company, provides a full range of trust and other fiduciary services to individuals, estates, business corporations and charitable organizations. The Company also owns all of the outstanding capital stock of First American Insurance Agencies, Inc., a Minnesota corporation, and First American Insurance Agencies, Inc., a North Dakota corporation (collectively, the "Insurance Agencies"). The Insurance Agencies sell insurance, with an emphasis on crop-hail, property and casualty insurance. In addition, the Company owns a controlling portion of the capital stock of Bremer First American Life Insurance Company, an Arizona life insurance company engaged in the underwriting and reinsurance of credit life, credit accident and health insurance sold in conjunction with loans made by the Subsidiary Banks. See "Business — Financial Service Subsidiaries."

The Company is an entity legally separate and distinct from the Subsidiary Banks and its financial service subsidiaries. The principal source of the Company's income and cash flow are dividends from the Subsidiary Banks. The payment of dividends by the Subsidiary Banks, the payment of dividends by the Company, and certain other aspects of the operations of the Company and the Subsidiary Banks are subject to regulation and control by the various bank regulatory agencies. See "Special Considerations — Risks Inherent in Banking Industry — Restrictions on Payment of Dividends by the Subsidiary Banks to the Company," "Special Considerations — Risks Inherent in Banking Industry — Restrictions on Payment of Dividends on Class A and Class B Common Stock," "Supervision and Regulation — Regulation of the Company" and "Supervision and Regulation — Regulation of Subsidiary Banks."

SPECIAL CONSIDERATIONS

An investment in the Class A Common Stock involves certain special considerations and risks. Each prospective investor should carefully consider all of the following special considerations and risks in addition to the information set forth elsewhere in this Prospectus.

Risks Inherent in Banking Industry

There are certain special considerations and risks inherent in the business of banking that are not unique to the Company or the Subsidiary Banks but are common to all entities involved in the banking industry. Set forth below are some of the special considerations and risks inherent in the business of banking.

Regulation of Bank Holding Companies

The United States banking system is highly regulated, with both individual states and the federal government having rights regarding the chartering, supervision and examination of banks and bank holding companies. Bank holding companies, including the Company, and state and national banks, including the Subsidiary Banks, are each subject to state and federal regulation and supervision. The Company is subject to the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"), and to regulation and supervision by the Federal Reserve System (including the Federal Reserve Board). The Federal Reserve Board possesses cease and desist powers over bank holding companies to prevent or remedy unsafe or unsound practices or violations of law. These and other restrictions limit how the Company may conduct its business and obtain financing. See "Supervision and Regulation — Regulation of Company."

Regulation of the Subsidiary Banks

The Subsidiary Banks are subject to supervision and examination by the Comptroller of the Currency (the "Comptroller") in the case of national Subsidiary Banks, the Minnesota Department of Commerce in the case of the Subsidiary Banks incorporated in Minnesota, the North Dakota Department of Banking and Financial Institutions for Subsidiary Banks domiciled in North Dakota, and the Wisconsin Commissioner of Banking for Subsidiary Banks formed under Wisconsin law. The state Subsidiary Banks are also subject to examination of their financial and business affairs by the Federal Deposit Insurance Corporation ("FDIC"). The various federal and state laws and regulations apply to many aspects of the Subsidiary Banks' operations and financial condition, including reserves, deposits, loans, investments, mergers, acquisitions and the establishment of branch offices and facilities. These and other restrictions limit how the Subsidiary Banks may conduct their businesses and obtain financing. See "Supervision and Regulation — Regulation of Subsidiary Banks."

Restrictions on Payment of Dividends by the Subsidiary Banks to the Company

The Company's cash flow and income are dependent on the ability of the Subsidiary Banks to pay cash dividends to the Company. Therefore, the ability of the Company to pay cash dividends on the Class A Common Stock and the Class B Common Stock will depend upon the amount of cash dividends paid to the Company by the Subsidiary Banks. The payment of dividends by national and state Subsidiary Banks is subject to certain financial requirements and to the approval of the appropriate banking authority. Further, in some cases, the appropriate federal or state banking agency could take the position that it has the power to prohibit a national or state bank from paying dividends if, in its view, such payments would constitute unsafe or unsound banking practices. In addition, whether dividends are paid and their frequency and amount will depend on the financial condition and performance, and the discretion of management, of the various Subsidiary Banks. The Subsidiary Banks have been paying cash dividends to the Company on a consistent basis adequate for its cash flow needs. In addition, the Company has been paying sufficient cash dividends to the Foundation to allow the Foundation to comply with the requirement under Section 4942 of the Code to make annual "qualifying distributions," including annual grants, equal to at least 5% of the fair market value of the Foundation's assets as of the last day of the previous fiscal year, which assets consist primarily of the capital stock of the Company. See "Dividends." However, the above restrictions on dividends paid by the Subsidiary Banks may limit the Company's ability to obtain funds from such dividends for its cash needs, including funds for payment of operating expenses and the payment of cash dividends on shares of Class A Common Stock and Class B Common Stock. A holder of shares of Class B Common Stock (which now consists of only the Foundation) would have the right to convert such shares into shares of Class A Common Stock with full voting rights, at the affirmative election of such holder, if cash dividends had not been paid on the Class A Common Stock and the Class B Common Stock in any fiscal year (beginning in 1989) in an amount equal to at least 5% of the Company's consolidated net book value as of the last day of the immediately preceding fiscal year (beginning with 1988). This 5% dividend standard is based upon the requirement of the Foundation to distribute in grants in any year certain amounts as described above. See "Dividends."

Restrictions on Payment of Dividends on Class A and Class B Common Stock

The payment of dividends by the Company to the holders of Class A Common Stock and Class B Common Stock is affected by the requirement imposed on the Company to maintain adequate capital pursuant to the capital adequacy guidelines issued by the Federal Reserve Board and is subject to the discretion of the Company's Board of Directors. See "Supervision and Regulation — Regulation of Company." These limitations could affect the ability of the Company to pay dividends to holders of Class A Common Stock and Class B Common Stock. If the Company does not pay cash dividends to the holders of Class A Common Stock and Class B Common Stock in any fiscal year (beginning in 1989) in an amount equal to 5% of the Company's consolidated net book value as of the last day of the immediately preceding fiscal year (beginning with 1988), each share of Class B Common Stock could be converted into one share of Class A Common Stock with full voting rights upon the affirmative election of the holders of the Class B Common Stock. If the Foundation owned 240,000 shares of Class A Common Stock and all shares of Class B Common Stock and elected to convert all of its shares of Class B Common Stock into Class A Common Stock upon the failure of the Company to pay such dividends, the Foundation would own 92% of the voting control of the Company. See "Special Considerations — Special Considerations Regarding an Investment in the Company — Voting Control of Company."

Historically, the Company has not paid dividends to the Foundation in any fiscal year equal to at least 5% of the Company's consolidated net book value as of the last day of the immediately preceding fiscal year, although the Company would have had sufficient cash flow to do so had the Subsidiary Banks paid to the Company a greater amount of dividends, which they could have done under applicable banking regulations. See "Dividends." Therefore, and only on a historical basis, the Foundation would have had the right to convert its shares of Class B Common Stock into Class A Common Stock and thereby own 92% of the voting control of the Company. To avoid having the Foundation obtain this right, the Company will have to increase its dividend payments to the Foundation, the sole source of which is dividend payments from the Subsidiary Banks, which may be subject to regulatory approval. See "Dividends," "Supervision and Regulation — Regulation of Subsidiary Banks," and "Description of Capital Stock — Description of Class B Common Stock."

Deregulation

There have been significant changes in the banking industry in recent years. Many of the changes have resulted from federal legislation intended to deregulate the banking industry. This legislation has, among other things, eliminated interest rate restrictions on deposits and increased the power of non-banks to expand into traditional banking services. Future changes in the banking industry may include some modification of prohibitions on the type of businesses in which bank holding companies may engage. In addition, other types of financial institutions, including securities brokerage companies, insurance companies, and investment banking firms, have been given and may continue to be given powers to engage in activities which traditionally have been engaged in only by banks. Such changes would tend to place the Company and the Subsidiary Banks in more direct competition with other financial institutions. See "Business — Competition" and "Supervision and Regulation — Deregulation."

Competition

The banking business is highly competitive. The Subsidiary Banks compete with other banks, savings and loan associations, credit unions and other financial institutions in their local communities for loans and deposits. The Subsidiary Banks also compete indirectly with regional and national financial institutions. In addition, and while the Company cannot predict the impact of interstate banking, it anticipates that competition may intensify as local institutions become part of larger national organizations. If the Company and the Subsidiary Banks are unable to successfully compete, the business and operations of the Company and the Subsidiary Banks could be adversely affected. See "Business — Competition."

Special Considerations Regarding an Investment in the Company

In addition to the special considerations and risks inherent in the banking business described above, there are special considerations and risks associated with an investment in the Company and the Class A Common Stock, as described below.

Voting Control of Company

After the sale of 960,000 shares of Class A Common Stock hereunder by the Foundation, the Foundation will own 20% of the issued and outstanding shares of Class A Common Stock (consisting of 240,000 shares) and 100% of the issued and outstanding shares of Class B Common Stock (consisting of 10,800,000 shares).

The shares of Class A Common Stock have full rights to vote on all matters properly before the Company's shareholders (including the election of the Company's Directors). However, and except with respect to "Extraordinary Transactions" (as such term is defined below), the Foundation has and will have no rights to vote the shares of Class B Common Stock on any issue properly submitted to a vote of the Company's shareholders. Therefore, although the Foundation can vote the 20% of the outstanding shares of Class A Common Stock it will hold after this offering, its vote will not be controlling. With respect to a vote on an Extraordinary Transaction, the Foundation has the same right to vote the Class B Common Stock as the Class A Common Stock; that is, it would have one vote per share of Class A Common Stock and one vote per share of Class B Common Stock. Therefore, it would be entitled to vote 92% of the capital stock of the Company with respect to an Extraordinary Transaction and would control the vote with respect to an Extraordinary Transaction. An Extraordinary Transaction consists of a vote on the merger, consolidation, liquidation, or dissolution of the Company; a sale of all or substantially all of the Company's assets; or an amendment to the Company's Articles of

Incorporation which would change the Company's capital structure or the voting power of the Class A Common Stock or the Class B Common Stock. See "Description of Capital Stock — Description of Class B Common Stock."

Each share of Class B Common Stock is convertible into a share of Class A Common Stock with full voting rights (i) at the affirmative election of a third party or entity upon a transfer of such share of Class B Common Stock by the Foundation to such third party or entity; or (ii) at the affirmative election of the holder of Class B Common Stock if cash dividends have not been paid on the Class A Common Stock and the Class B Common Stock in any fiscal year of the Company (beginning in 1989) in an amount equal to at least 5% of the Company's consolidated net book value as of the last day of the immediately preceding fiscal year (beginning with 1988). Therefore, the Foundation could obtain voting control of the Company upon the conversion into Class A Common Stock of more than 720,000 shares of Class B Common Stock, assuming it continued to own 240,000 shares of Class A Common Stock. A holder of Class B Common Stock owning no Class A Common Stock (such as a transferee of the Foundation's shares of Class B Common Stock) could obtain voting control of the Company's capital stock upon the conversion into Class A Common Stock of more than 1,200,000 shares of Class B Common Stock. See "Description of Capital Stock — Description of Class B Common Stock."

Dependence on Local Economic Conditions

Every bank, including each of the Subsidiary Banks, is affected by the economic conditions and the economy of the area in which it operates. Because many of the Subsidiary Banks are located in rural areas dependent on agriculture, the Subsidiary Banks and the Company on a consolidated basis experienced an increase in credit risk and nonperforming loans when the agricultural economy declined in 1984 through 1986. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Corporate Risk Profile" and "Business — Subsidiary Banks — Subsidiary Banks' Communities." While the negative impact of the depressed agricultural economy on the Company has been reduced by improved credit practices and the recent improvement in the agricultural economy, there can be no assurance that future adverse economic conditions will not have a negative impact upon the quality of the Subsidiary Banks' loan portfolio and the Company's earnings. Therefore, the Subsidiary Banks and the Company remain vulnerable to downturns in the economies of the areas in which the Subsidiary Banks operate and particularly to downturns in the agricultural economy. The drought of 1988 has had a minimal impact on the Company. However, the full impact cannot be determined at this time, particularly if the drought continues. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Corporate Risk Profile."

Restrictions on Transfer of Shares; Lack of Active Market; Market Value

Under the Plan of Reorganization and the Company's Articles of Incorporation, the Company would have an option to purchase a holder's shares of Class A Common Stock upon a proposed transfer of such shares. Therefore, shares of Class A Common Stock purchased in this offering may be resold only if the Company does not exercise this option and then only if (i) the transferee agrees in writing to be bound by the Plan of Reorganization, and (ii) the purchaser provides an opinion of counsel satisfactory to the Company that the shares may be sold under applicable securities laws. There has been no market for the Class A Common Stock, and, given these restrictions on transfer, it is likely that any market that develops after the offering will be only a limited market. Therefore, investors may not be able to readily and quickly sell their Class A Common Stock as easily as if it were freely tradeable on the open market with no restrictions on transfer. See "Description of Capital Stock — Description of Class A Common Stock."

Because of the restrictions on the transfer of shares of Class A Common Stock described above, such shares will not be freely tradeable and will have limited marketability. Although the Company cannot guarantee the market price of the Class A Common Stock, management anticipates that it will trade at a price approximating its book value at the time the trade is made. Consequently, the market price of the Class A Common Stock probably will not be as affected by market conditions that typically affect the market price of securities that are freely tradeable without restriction.

Obligation of Shareholders to Sell Shares

Upon the occurrence of certain events, the Company or its assignee will have an option to purchase a holder's shares of Class A Common Stock, and, upon exercise of such option, the holder will be obligated to sell the Class A Common Stock to the Company or its assignee. The events which give rise to this option consist of the holder's proposal to sell or otherwise transfer the Class A Common Stock in a voluntary or an involuntary transfer; the death of the holder (if the holder is a natural person); and, if the holder of the Class A Common Stock is an employee of the Company or any of its subsidiaries, the retirement or termination of employment of the holder. The option exercise price for the shares of Class A Common Stock would be equal to the book value per share of Class A Common Stock as shown on the Company's consolidated balance sheet dated as of the last day of the immediately preceding fiscal quarter (with the possible exception of any shares held by an individual by reason of a distribution from the ESOP). In any case, the purchase price paid by the Company or its assignee could be less than the price for which the holder could sell the shares of Class A Common Stock to a party other than the Company or its assignee. See "Description of Capital Stock — Description of Class A Common Stock."

The Foundation, its assignee, or its transferee will have an option to buy the Class A Common Stock upon the sale of all or substantially all of the shares of Class B Common Stock held by the Foundation. If the Foundation exercised this option, the holders of shares of Class A Common Stock purchased hereunder would have an obligation to sell their shares to the Foundation, its designated assignee, or the Foundation's transferee. With the exception of any Class A Common Stock owned or distributed by the Company's ESOP (the "ESOP Stock"), the exercise price per share of such option would be equal to the greater of (i) the book value per share of Class A Common Stock set forth on the Company's consolidated balance sheet dated as of the last day of the immediately preceding fiscal quarter; or (ii) the average price per share realized by the Foundation for the sale of its Class B and Class A Common Stock. With respect to the ESOP Stock, the exercise price per share of the Foundation's option would be equal to the greater of an amount determined under paragraphs (i) and (ii) above or (iii) the fair market value of the Class A Common Stock as determined as provided in the ESOP. In any case, the purchase price paid by the Foundation or its transferee could be less than the price for which the holder could sell the Class A Common Stock other than pursuant to the exercise of the Foundation's option. See "Description of Capital Stock — Description of Class A Common Stock."

Upon the sale of all or substantially all of the Class B Common Stock by the Foundation, the holders of Class A Common Stock would have the right to sell the Class A Common Stock to the Foundation or its transferee for a price per share equal to the average sales price per share realized by the Foundation for the sale of its Class A and Class B Common Stock. If the average price per share to be received by the Foundation upon such sale was less than the book value of the Class A Common Stock, and the Foundation or its transferee did not exercise its option to purchase the Class A Common Stock as described above, the holders of Class A Common Stock exercising their right to sell their shares to the Foundation or the transferee would receive less than the book value of such shares. See "Description of Capital Stock — Description of Class A Common Stock."

In addition, the sale of shares of Class A Common Stock upon the exercise of an option by the Company, the Foundation, their assignees, or the holder of Class A Common Stock may be subject to the approval of state and/or federal authorities, and, with respect to an option exercised by the Company, to the financial condition of the Company at the time the option is exercised. See "Description of Capital Stock — Description of Class A Common Stock."

Company's Obligation to Purchase Shares

A holder of shares of Class A Common Stock has the right to require the Company to purchase such shares from the holder (i) if the shares were distributed to the holder from the Company's ESOP and at the affirmative election of such holder at any time within fifteen months from the date of such distribution; or (ii) upon the death, permanent disability, or retirement of a holder who is an employee of the Company. In addition, the Company may agree with individual non-employee directors of Subsidiary Banks who purchase shares in this offering to grant to such director a put option that would require the Company or its designated assignee to purchase all shares of Class A Common Stock then owned by such director if he or she ceases to be a director. In case (i), the purchase price per share would be equal to the fair market value of the shares of the Class A Common Stock being sold as established by the most recent annual appraisal. See "Description of Capital Stock — Description of Class A Common Stock." In case (ii), and in the case of an option granted to a non-employee director, the purchase price per share would be equal to the book value per share as shown on the Company's consolidated financial statements as of the last day of the immediately preceding fiscal quarter. However, the Company is not obligated to purchase any shares of Class A Common Stock from a holder if the purchase price for such shares, when added to the purchase price paid by the Company for all previous purchases of Class A Common Stock during the preceding twelve-month period, would exceed 10% of the Company's net worth as of the date of such purchase. As of December 31, 1988, the Company's net worth was $132 million, and 10% of the Company's net worth was $13.2 million. Furthermore, such purchase may be subject to the approval of state and federal authorities and the financial condition of the Company at the time of purchase. See "Description of Capital Stock — Description of Class A Common Stock."

USE OF PROCEEDS

The net proceeds to be received by the Foundation from the sale of the shares of Class A Common Stock in this offering, after deducting estimated offering expenses of $340,000, will be approximately $10,450,400. The Foundation plans to invest these proceeds through a professional money manager as principal in United States government obligations with maturities of less than seven years and in equity securities. The income from these investments would be available to the Foundation to fund future grants. Therefore, the sale of the shares of Class A Common Stock by the Foundation in this offering, in addition to satisfying the divestiture requirements of Section 4943 of the Code, will enable the Foundation to diversify its asset base, which currently consists primarily of the Class A Common Stock and Class B Common Stock of the Company. None of the offering proceeds will be applied or available for application to the operations of the Company or its subsidiaries, including the Subsidiary Banks.

DIVIDENDS

The Subsidiary Banks' ability to pay dividends to the Company, the Company's ability to pay dividends to holders of the Class A Common Stock and Class B Common Stock, and the ability of the Subsidiary Banks to loan funds to the Company are restricted and limited as described in "Supervision and Regulation." The Subsidiary Banks may pay dividends to the Company if the Subsidiary Banks are in compliance with the statutory restrictions on the payment of dividends. Subsidiary Banks incorporated under Minnesota law must obtain the approval of the Commissioner of Commerce before paying dividends, which approval is usually granted unless the dividends exceed certain limits, in which case special approval must be obtained. Subsidiary Banks formed under North Dakota or Wisconsin law and national Subsidiary Banks must obtain regulatory approval prior to paying dividends if such dividends exceed the applicable statutory limits. See "Supervision and Regulation — Regulation of Subsidiary Banks." As of December 31, 1986, 1987 and 1988, the Subsidiary Banks had retained earnings of $41.9 million, $35.9 million and $44.8 million, respectively, which were available for distribution in the subsequent year subject to these limitations. Of these amounts, $7.6 million, $10.2 million and $11.0 million, respectively, were available for distribution to the Company as dividends in the subsequent year without obtaining the prior approval of the appropriate bank regulator.

The Company declared and paid dividends to the Foundation of $3.8 million in 1987 and $3.9 million in 1988. The dividend yield, which consists of dividends paid during the year divided by shareholder's equity as of the last day of the preceding year, was 3.4% and 3.2%, respectively, for the years ended December 31, 1987 and 1988. In 1987, $700,000 of dividends were paid in the second quarter, $900,000 were paid in the third quarter, and $2.2 million were paid in the fourth quarter. In 1988, $1.0 million of dividends were paid in the second quarter, $1.2 million in the third quarter, and $1.7 million in the fourth quarter.

The Company currently expects to declare and pay quarterly dividends in the future in amounts sufficient to prevent the holders of shares of Class B Common Stock from having the right to convert their shares into shares of Class A Common Stock with full voting rights. If the holders of Class A Common Stock and Class B Common Stock do not receive in any fiscal year (beginning in 1989) cash dividends in an amount equal to at least 5% of the Company's consolidated net book value as of the last day of the immediately preceding fiscal year (beginning with 1988), shares of Class B Common Stock could be converted into shares of Class A Common Stock at the election of the holders of the Class B Common Stock. See "Description of Capital Stock — Description of Class B Common Stock." To prevent the holder of shares of Class B Common Stock from obtaining this right, the Company would have had to pay additional dividends of $1.8 million and $2.2 million for the years ended December 31, 1987 and 1988, respectively. The Company's cash flow would have been sufficient to pay these additional dividends had the Subsidiary Banks paid higher dividends. During 1987 and 1988, out of the portion of retained earnings available for distribution as dividends without regulatory approval of $7.6 million and $10.2 million, respectively, the Subsidiary Banks could have paid additional dividends to the Company equal to $1.8 million and $2.2 million, respectively, permitting the Company to make the 5% payout.

The Foundation is required by Section 4942 of the Code to make annual "qualifying distributions," including annual grants, equal to at least 5% of the fair market value of the Foundation's assets as of the last day of the previous fiscal year, subject to certain qualifications. Because substantially all of the Foundation's income is derived from the Company's dividends, and because substantially all of the Foundation's assets consist of its investment in the Company, the payment of the 5% dividend by the Company to the Foundation would allow the Foundation to meet its pay-out requirements under Section 4942 of the Code and also meet its philanthropic responsibilities.

Since 1985, the total dividends paid by the Subsidiary Banks to the Company have more than doubled from $4.1 million in 1985 to $9.7 million in 1988. Four Subsidiary Banks paid no dividends in 1988 as a result of efforts to strengthen their level of capitalization. Two of these Subsidiary Banks are operating under capital forebearance policies, and, as of December 31, 1988, both of these Subsidiary Banks had capital levels above the required minimum set forth in their respective forebearance policy. Of the Subsidiary Banks that paid dividends in 1988, the range of dividends payouts (dividends paid divided by net income) was 11% to 162%. The Company's management anticipates that beginning in 1989, the Company's annual cash flow will be sufficient to pay dividends equal to at least 5% of the Company's consolidated net book value as of the last day of the immediately preceding fiscal year. See "Supervision and Regulation" and the financial statements included elsewhere in this Prospectus.

The payment of dividends with respect to shares of Class A Common Stock held in the Profit Sharing Plan and the ESOP are described in "Management — Compensation Pursuant to Plans."

CAPITALIZATION

The following table sets forth the capitalization of the Company as of December 31, 1988 and as adjusted to give effect to the adoption of the Plan of Reorganization and the sale by the Foundation of the 960,000 shares of Class A Common Stock offered hereby:

	December 31, 1988 Actual and As Adjusted (In Thousands)
Shareholder's equity:	
Common Stock:	
Class A, no par value; 12,000,000 shares authorized; 1,200,000 shares issued and outstanding	$ 285
Class B, no par value; 10,800,000 shares authorized, issued and outstanding	2,562
Retained earnings	129,486
Total shareholder's equity	132,333
TOTAL CAPITALIZATION	$132,333

SELECTED CONSOLIDATED FINANCIAL DATA

The following table summarizes selected consolidated financial information and is qualified in its entirety by more detailed financial information and notes appearing elsewhere in this Prospectus.

	For the Year Ended December 31,				
	1984	1985	1986	1987	1988
	(In thousands, except per share amounts and ratios)				
Summary of Operations					
(Tax equivalent basis)					
Interest income (1)	$ 170,706	$ 168,766	$ 157,428	$ 148,114	$ 154,213
Interest expense	103,643	97,914	86,735	76,990	82,314
Net interest income	67,063	70,852	70,693	71,124	71,899
Provision for loan losses	15,832	23,548	15,063	8,811	6,418
Net interest income after provision for loan losses	51,231	47,304	55,630	62,313	65,481
Noninterest income	10,521	19,718	24,445	19,234	18,141
Noninterest expense	49,552	54,095	57,860	59,316	59,666
Income before income tax expense	12,200	12,927	22,215	22,231	23,956
Income tax expense (1)	6,962	6,849	11,181	9,542	9,082
Net income	$ 5,238	$ 6,078	$ 11,034	$ 12,689	$ 14,874
Other Data					
Per share of common stock (2)					
Net income	$ 0.44	$ 0.51	$ 0.92	$ 1.06	$ 1.24
Cash dividends paid	0.21	0.21	0.25	0.32	0.33
Book value at end of period	8.40	8.70	9.37	10.11	11.03
Selected balances — end of period					
Total assets	$1,495,986	$1,560,521	$1,612,471	$1,624,046	$1,702,373
Loans	914,586	927,501	934,383	964,422	1,026,584
Deposits	1,250,362	1,334,503	1,387,078	1,409,607	1,474,281
Long term debt	10,485	9,386	6,396	5,117	4,015
Shareholder's equity	100,858	104,436	112,470	121,359	132,333
Ratios					
Return on average assets (3)	0.52%	0.51%	0.78%	0.85%	0.97%
Return on average equity	5.31	5.96	10.11	10.79	11.73
Equity to assets — average	6.83	6.78	7.01	7.43	7.75
Selected balances — average					
Shareholder's equity	$ 98,603	$ 102,019	$ 109,119	$ 117,615	$ 126,836
Total assets	1,444,089	1,505,346	1,556,188	1,582,737	1,636,307

(1) Tax equivalency adjustments for the years ended December 31, 1984, 1985, 1986, 1987 and 1988 were $11,326,000, $10,332,000, $10,125,000, $6,641,000 and $4,782,000, respectively.

(2) All per share amounts have been restated to reflect the issuance of 1,200,000 shares of Class A Common Stock and 10,800,000 shares of Class B Common Stock pursuant to the Plan of Reorganization.

(3) Consists of net income for the year indicated plus minority interests in earnings of subsidiaries divided by total average assets for the same year.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with the financial statements and related notes included elsewhere in this Prospectus.

Performance Overview

Earnings Summary

The Company's net income has risen from $6.1 million in 1985 to $14.9 million in 1988, which is a three-year compound growth rate of 35%. The improving credit quality with the corresponding reduced levels of the provision for loan losses, combined with gains from investment securities, were the predominant reasons for the increased earnings during the three-year period. The provision for loan losses declined from a record high level in 1985 of $23.5 million to $15.1 million in 1986, $8.8 million in 1987, and to a more normal level of $6.4 million in 1988 due to a combination of stronger credit administration procedures and economic improvements in the communities served. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Income Statement Analysis — Provision for Loan Losses" and "Management's Discussion and Analysis of Financial Condition and Results of Operations — Corporate Risk Profile — Credit Management." The investment securities gains were $9.2 million in 1986, $1.2 million in 1987, and $59,000 in 1988. Excluding these items, core earnings (income before investment securities gains, minority interests in earnings of subsidiaries, and taxes) rose from $4.0 million in 1986 to $15.2 million in 1987 and $20.1 million in 1988.

The Company posted record earnings in 1988 of $14.9 million, up $2.2 million, or 17.2%, from $12.7 million in 1987. The reduction in the provision for loan losses had a significant impact on 1988 results. The improvement in net interest income and a reduction in income tax rates also contributed to the increase.

Table I sets forth consolidated performance ratios for the years indicated:

TABLE I

Performance Ratios

	For the Year Ended December 31,		
	1986	1987	1988
Performance Ratios			
Return on average assets	0.78%	0.85%	0.97%
Return on average equity	10.11	10.79	11.73
Dividend payout ratio	27.19	29.95	26.22

Return on average assets is a key measure of profitability that indicates how effectively the Company is utilizing its assets. It is calculated by dividing net income plus minority interests in earnings of subsidiaries by total average assets. Consistent with the trend of increasing earnings, the Company's return on average assets was 0.78% in 1986, 0.85% in 1987, and 0.97% in 1988. See Table II for a schedule detailing the changes in return on assets.

Return on average shareholder's equity ("ROE"), another key measure of profitability, indicates the Company's return on shareholder's investment. It is calculated by dividing net income by total average shareholder's equity. As set forth in Table I, ROE rose each year from 10.11% in 1986 to 10.79% in 1987 and to 11.73% in 1988, due to increased earnings.

Table II sets forth changes in return on assets for the periods indicated:

TABLE II

Changes in Return on Assets (ROA)

	For the Year Ended December 31,		
	1986 vs. 1985	1987 vs. 1986	1988 vs. 1987
Return on Assets (ROA) — previous year	0.51%	0.78%	0.85%
Increase			
Net interest income	—	0.18	0.03
Provision for loan losses	0.60	0.41	0.16
Service charge income	0.02	—	—
Insurance	0.01	—	0.02
Trust	0.02	0.03	—
Investment securities gains	0.54	—	—
Other noninterest income	—	0.13	—
Personnel expense	—	—	0.01
Furniture and equipment	—	—	0.01
Other noninterest expense	—	0.15	0.12
Total increases	1.19	0.90	0.35
Decreases			
Net interest income	0.13	—	—
Service charge income	—	—	0.01
Investment securities gains	—	0.52	0.07
Gain from pension reversion	0.30	—	—
Other noninterest income	0.03	—	0.05
Personnel expense	0.08	0.10	—
Occupancy expense	0.02	0.01	0.02
Furniture and equipment expense	0.01	0.08	—
Other noninterest expense	0.05	—	—
Provision for income taxes	0.30	0.12	0.08
Total decreases	0.92	0.83	0.23
Return on Assets (ROA) — current year	0.78%	0.85%	0.97%

Balance Sheet Summary

The Company experienced modest growth in certain balance sheet items during 1987 and 1988. Average assets rose 1.7% in 1987 and 3.4% in 1988. This growth occurred despite the constraints of the economy during the same periods. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Balance Sheet Analysis — Use of Funds."

The growth of the Company's balance sheet was driven by increasing customer deposits, which are the primary source of funds. Average deposits increased 2.8% in 1987 and 2.4% in 1988. These additional funds provided for growth in two significant earning asset categories — investment securities and loans. Average investment securities increased 7.8% in 1987 and 4.5% in 1988. Average total loans grew very slowly in 1987 due to reduced loan demand, increasing 1.5%. This was followed by improved loan demand in 1988, when total average loans increased 3.9%.

Dividends and Shareholder's Equity

Dividends paid to the Foundation as the Company's sole shareholder have increased over the past several years. The dividends of $3.8 million paid in 1987 represented an increase of $800,000, or 27%, from the dividends paid in 1986, and the dividends of $3.9 million paid in 1988 represented an increase of $100,000, or 2.6%, from the dividends paid in 1987. See "Dividends."

Total shareholder's equity has increased each year since December 31, 1986. These increases are solely the result of net earnings retention. Total shareholder's equity increased 7.9% in 1987 and 9.0% in 1988.

The Company's capital position is both a strength and an opportunity, as it provides a degree of safety and soundness and a foundation for future growth. Compared to the regulatory requirement of the Federal Reserve Board that imposes a 5.5% minimum primary capital ratio (the ratio of shareholder's equity, minority interests and reserve for loan losses to assets), the Company had primary capital ratios of 8.5%, 8.9%, and 9.3% at December 31, 1986, 1987, and 1988, respectively.

Table III sets forth consolidated capital ratios as of the dates indicated:

TABLE III

Capital Ratios

	December 31,		
	1986	**1987**	**1988**
Capital Ratios			
Equity to assets — average	7.01%	7.43%	7.75%
Primary capital ratio	8.49	8.94	9.25
Tier 1/risk weighted assets	11.08	11.26	11.43
Tier 1+2/risk weighted assets	12.35	12.45	12.61

On December 16, 1988, December 21, 1988, and March 14, 1989, the Federal Reserve Board, the Comptroller, and the FDIC, respectively, adopted as final their risk-based capital adequacy guidelines proposed in March 1988. See "Supervision and Regulation — Regulation of Company." Under these new guidelines, which affect all banks (including the Subsidiary Banks), different categories of assets are assigned different risk weights ranging from 0% for risk-free assets (such as cash) to 100% for relatively high-risk assets (such as loans). The guidelines provide that these risk weights are to be multiplied by corresponding asset balances to determine a "risk-adjusted" asset base. Certain off-balance sheet items (such as letters of credit) which were not considered in capital adequacy computations under the previous guidelines are also added to the risk-adjusted asset base under the new guidelines. The standard also changes the capital components of Tier 1 (core) capital, which is common equity capital alone, and Tier 2, or supplementary capital, which consists of preferred stock, the reserve for loan losses, and subordinated debt. The new guidelines set forth minimum requirements of 4% for Tier 1 capital and 8% for total capital (Tier 1 plus Tier 2) by December 31, 1992. At December 31, 1988, the Company's risk-adjusted capital adequacy ratios were above the minimums set forth in the guidelines. As set forth in Table III, at December 31, 1986, 1987, and 1988, the Company had Tier 1 capital ratios of 11.08%, 11.26%, and 11.43%, respectively, and the total capital ratios (Tier 1 plus Tier 2) were 12.35%, 12.45%, and 12.61%, respectively.

Income Statement Analysis

Net Interest Income

The most significant component of the Company's earnings is net interest income, which is the difference between interest earned on assets and interest paid on liabilities. Table IV sets forth the consolidated average balance sheet and related yields and rates and shows the sources of interest income and expense for the years indicated. Adjustments have been made to present yields on a tax equivalent basis with interest on tax-exempt assets as if such assets were fully taxable.

TABLE IV

Consolidated Average Balance Sheet and Related Yields and Rates

	For the Year Ended December 31,								
	1986			1987			1988		
	Average Balance	Interest (1)	Rate/ Yield	Average Balance	Interest (1)	Rate/ Yield	Average Balance	Interest (1)	Rate/ Yield
	(Dollar amounts in thousands)								
Assets									
Loans (net of unearned discount)									
Commercial and other	$ 272,400	$ 29,229	10.73%	$ 299,814	$ 31,117	10.38%	$ 311,108	$ 32,929	10.58%
Agricultural	203,535	22,169	10.89	187,922	20,180	10.74	191,374	21,248	11.10
Real estate	272,446	30,714	11.27	283,576	30,072	10.60	301,178	31,420	10.43
Consumer	121,326	15,301	12.61	116,791	13,251	11.35	124,113	13,914	11.21
Tax exempt	64,007	10,596	16.55	59,169	8,271	13.98	56,402	7,254	12.86
Total loans	933,714	108,009	11.57	947,272	102,891	10.86	984,175	106,765	10.85
Reserve for loan losses	(18,012)			(18,405)			(18,805)		
Net loans	915,702			928,867			965,370		
Investment securities									
Taxable	369,309	32,243	8.73	418,209	32,698	7.82	446,129	36,263	8.13
Nontaxable	84,040	11,895	14.15	70,446	9,070	12.87	64,667	7,629	11.80
Total investment securities	453,349	44,138	9.74	488,655	41,768	8.55	510,796	43,892	8.59
Interest bearing deposits	28,118	2,357	8.38	27,537	1,974	7.17	23,909	1,878	7.85
Federal funds sold	31,595	2,159	6.83	15,552	1,034	6.65	18,673	1,464	7.84
Other earning assets	6,540	765	11.71	4,535	447	9.86	2,051	214	10.43
Total earning assets	1,453,316	157,428	10.83	1,483,551	148,114	9.98	1,539,604	154,213	10.02
Cash and due from banks	59,578			57,181			56,206		
Nonearning assets	61,306			60,410			59,302		
Total assets	$1,556,188			$1,582,737			$1,636,307		
Liabilities and Shareholder's Equity									
Noninterest bearing deposits	$ 161,667			$ 165,133			$ 161,469		
Interest bearing deposits									
Savings and NOW accounts	185,648	9,280	5.00	219,779	10,344	4.71	208,966	9,471	4.53
Money market checking	68,982	3,489	5.06	78,100	3,619	4.63	85,339	4,033	4.73
Money market savings	167,220	9,228	5.52	172,264	8,578	4.98	159,879	8,322	5.21
Savings certificates	650,135	52,436	8.07	625,271	43,203	6.91	671,935	47,125	7.01
Certificates over $100,000	99,881	7,110	7.12	110,191	7,183	6.52	116,626	8,399	7.20
Total time deposits	1,171,866	81,543	6.96	1,205,605	72,927	6.05	1,242,745	77,350	6.22
Total deposits	1,333,533			1,370,738			1,404,214		
Short-term borrowings	67,789	4,441	6.55	57,175	3,569	6.24	65,827	4,548	6.91
Long-term debt	8,060	751	9.31	5,501	494	8.98	5,076	416	8.20
Total interest bearing liabilities	1,247,715	86,735	6.95	1,268,281	76,990	6.07	1,313,648	82,314	6.27
Other liabilities	28,326			23,567			26,052		
Total liabilities	1,437,708			1,456,981			1,501,169		
Minority interests	9,361			8,141			8,302		
Shareholder's equity	109,119			117,615			126,836		
Total liabilities and equity	$1,556,188			$1,582,737			$1,636,307		
Net interest income		$ 70,693			$ 71,124			$ 71,899	
Net interest margin			4.86%			4.79%			4.67%

(1) Interest and rates are presented on a fully taxable equivalent basis using a 46% tax rate in 1986, a 40% tax rate in 1987, and a 34% tax rate in 1988. Interest income on loans includes loan fees. Average loan balances include nonaccrual loans.

Net interest margin measures the effectiveness of generating net interest income on earning assets and is calculated by dividing net interest income by earning assets. Net interest income and net interest margin are affected by changes in interest rates, changes in both the volume of earning assets and interest-bearing liabilities, and changes in the mix of earning assets and interest bearing liabilities. Table V shows how changes in volume, rates, mix and other factors have affected net interest income and net interest margin in the years indicated.

TABLE V

Changes in Net Interest Income

	For the Year Ended December 31,			
	1987 vs. 1986		1988 vs. 1987	
	Net Interest Income	Interest Margin (% Points)	Net Interest Income	Net Interest Margin (% Points)
	(Dollar amounts in thousands)			
Change in volume				
Earning assets	$ 3,219		$ 5,524	
Interest bearing liabilities	(1,429)		(2,754)	
	1,790		2,770	
Change in interest rate spread				
Earning assets	(9,863)	(0.67)%	2,930	0.19%
Interest bearing liabilities	9,986	0.67	(1,759)	(0.11)
	123	—	1,171	0.08
Change in product mix				
Earning assets	(1,308)	(0.09)	(617)	(0.04)
Interest bearing liabilities	1,188	0.08	(600)	(0.04)
	(120)	(0.01)	(1,217)	(0.08)
Change due to number of days				
Earning assets	—	—	400	—
Interest bearing liabilities	—	—	(211)	—
	—	—	189	—
Other changes				
Tax equivalent factor	(1,763)	(0.12)	(1,452)	(0.09)
Nonaccruing loans	1,113	0.07	734	0.05
Free funds	—	0.04	—	0.01
Yield related loan fees	(712)	(0.05)	(1,420)	(0.09)
	(1,362)	(0.06)	(2,138)	(0.12)
Change in net interest income	431	(0.07)	775	(0.12)
Balance at beginning of year	70,693	4.86	71,124	4.79
Balance at end of year	$71,124	4.79%	$71,899	4.67%

TABLE V
(continued)

	For the year ended December 31,					
	1987 vs 1986			1988 vs 1987		
	Volume	Yield/Rate(1)	Total	Volume	Yield/Rate(1)	Total
	(Dollar amounts in thousands)					
Increase (decrease) in:						
Interest income						
Loans	$ 1,469	$ (6,587)	$(5,118)	$3,960	$ (86)	$3,874
Investment securities	3,219	(5,589)	(2,370)	1,870	253	2,123
Interest bearing deposits	(52)	(331)	(383)	(263)	167	(96)
Federal funds sold	(1,167)	42	(1,125)	205	226	431
Other earning assets	(250)	(68)	(318)	(248)	15	(233)
Total interest income	3,219	(12,533)	(9,314)	5,524	575	6,099
Interest expense						
Time deposits	2,356	(10,972)	(8,616)	2,251	816	4,423
Short term borrowings	(690)	(182)	(872)	541	1,406	979
Long term debt	(237)	(20)	(257)	(38)	2,797	(78)
Total interest expense	1,429	(11,174)	(9,745)	2,754	5,019	5,324
Net interest income	$ 1,790	$ (1,359)	$ 431	$2,770	$(4,444)	$ 775

(1) The change in interest due to both rate and volume has been allocated entirely to change due to rate.

Tax equivalent net interest income for 1987 was $71.1 million, an increase of $431,000, or 0.6%, from the 1986 level of $70.7 million. This increase was primarily the result of a 2.1% increase in earning assets, as the net interest margin declined seven basis points to 4.79%. The margin was positively influenced by a lower level of nonaccruing loans and an increase in free funds. These were more than offset by the negative impact of the reduction in the tax equivalency adjustment factor caused by a reduced federal income tax rate (46% in 1986 and 40% in 1987) and lower yield related loan fees.

The changes in net interest income and the margin from 1987 to 1988 followed a very similar pattern. While net interest income increased $775,000, or 1.1%, to $71.9 million, the net interest margin declined twelve basis points to 4.67%. A growth of 3.8% in earning assets during 1988 caused the increase over 1987 in net interest income, despite the lower margin. The downward pressure on net interest margin resulted from changes in the product mix of both earning assets and interest bearing liabilities, the reduction in the tax equivalency factor in 1988 due to lower federal income tax rates (40% in 1987 and 34% in 1988), and a reduction in yield related loan fees. Offsetting positive influences were an improvement in the spread (the yields on earning assets increased more than the costs of interest bearing liabilities) and the reduction in nonaccruing loans.

The decrease in loan fees is the result of a significant decline in mortgage refinancing business in 1987 and 1988 and the adoption in 1988 of Statement of Financial Accounting Standards No. 91, Accounting for Loan Fees ("SFAS 91"). Loan fees declined $712,000, or 27%, from 1986 to 1987 due primarily to a decline in loan origination fees on mortgage refinancing. From 1987 to 1988, loan fees further declined by $1.4 million, or 74%; $800,000 was primarily due to a continued decline in mortgage refinancing, and $600,000 was due to SFAS 91. Lower interest rates prompted many customers to refinance their mortgages in 1986 and, to a lesser extent, in 1987, resulting in higher yield related loan fees. However, as interest rates rose in 1988, mortgage refinancing business declined. SFAS 91 requires loan fees to be capitalized and amortized into income over the life of the loan, as compared to the former practice of recognizing loan fee income at the time of loan origination.

Provision for Loan Losses

The Company's credit risk position has greatly improved since 1985, when the levels of the provision for loan losses and nonperforming assets were at historical highs. The provision for loan losses is based on management's assessment of the risks inherent in the loan portfolio, taking into consideration an evaluation of economic conditions, changes in the composition and size of the loan portfolio, net charge-offs, and the level of nonperforming loans. The condition in 1985 was a reflection of the distressed economies in the rural communities served and management's philosophy of taking a more conservative approach to problem identification, along with the adoption of standardized lending practices among the Subsidiary Banks.

Credit risk has been the Company's primary concern since loan losses escalated to unacceptable levels in 1985. This negative trend has been reversed for the loan portfolio as a whole. Through management's continued efforts and an improvement since 1986 in economic conditions of the Subsidiary Banks' communities, significant reductions in the loan loss provision, net charge-offs, and nonperforming loans have been experienced.

During the same period, the reserve for loan losses was strengthened both in dollars and as a percentage of loans outstanding. The reserve for loan losses increased $1.9 million, or 11%, from $16.6 million at December 31, 1985 to $18.5 million at December 31, 1988, and the reserve as a percentage of loans outstanding increased from 1.79% at December 31, 1985 to 1.80% at December 31, 1988.

In 1985, the provision for loan losses was $23.5 million, followed by a decline of $8.4 million, or 36%, to $15.1 million in 1986. A further reduction of $6.3 million, or 42%, to $8.8 million was experienced in 1987. The favorable trend continued into 1988, with a provision for loan losses of $6.4 million, a decrease of $2.4 million, or 27%, from 1987. (For further information, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations — Corporate Risk Profile — Credit Management" and "Business — Lending Policies, Practices, and Procedures.")

Noninterest Income

Total noninterest income declined in each year since 1986, primarily because the volume of investment securities gains declined each year. Operating noninterest income (noninterest income adjusted for investment securities gains) increased in each of the two years, with an 18% increase in 1987 and a 0.3% increase in 1988.

Table VI sets forth the components of noninterest income for the years indicated:

TABLE VI

Noninterest Income

	For the Year Ended December 31,		
	1986	1987	1988
	(In thousands)		
Service charges	$ 6,443	$ 6,597	$ 6,708
Insurance	3,353	3,422	3,921
Trust	2,283	2,722	2,809
Gain on sale of other real estate and fixed assets	288	1,013	952
Gain on sale of loans	—	1,124	502
Other	2,860	3,153	3,190
Operating noninterest income	15,227	18,031	18,082
Investment securities gains	9,218	1,203	59
Total noninterest income	$24,445	$19,234	$18,141

In 1987, operating noninterest income was $18.0 million, compared to $15.2 million in 1986, a $2.8 million, or 18%, increase. Gains on the sale of other real estate and fixed assets increased primarily due to aggressive efforts to dispose of real estate acquired through foreclosure. The Company entered the secondary market for real estate mortgage loans beginning in 1987, which resulted in a $1.1 million gain on sale of loans. In 1987, trust income increased by $439,000, or 19%, compared to 1986.

Operating noninterest income was $18.1 million in 1988, representing an increase of $51,000, or 0.3%, as compared to 1987. The increases in noninterest income included a $499,000, or 14.6%, increase in insurance income, a $111,000, or 1.7%, increase in service charge income, and an $87,000, or 3.2%, increase in trust income as trust assets under management increased $21.0 million, or 4%, to $555.0 million at December 31, 1988. These were offset by a $622,000, or 55%, decline in gain on sale of loans due to lower real estate mortgage loan activity.

Investment securities gains were $9.2 million in 1986, resulting from the sale of securities with market values that had substantially increased as a result of lower interest rates during the prior year. These securities gains enabled some Subsidiary Banks to recognize tax benefits while strengthening their reserve for loan losses. Investment securities gains were $1.2 million in 1987 and $59,000 in 1988. The gains recognized in 1987 resulted primarily from the liquidation of Sallie Mae common stock. Securities gains in 1988 were $59,000, as the unrealized gains in the portfolio declined due to rising interest rates.

Noninterest Expense

Since 1986, management has successfully controlled the growth of noninterest expense even though investment spending for the expansion of operations has occurred. A cost reduction program was implemented which was designed to increase control over hiring new personnel and to curtail or eliminate discretionary expenses. Noninterest expense increased 3.0% in 1987 during an expansion of data processing, insurance and trust operations. With these operations now in place, noninterest expense has increased less than 1% from 1987 to 1988.

Table VII sets forth the components of noninterest expense for the years indicated:

TABLE VII

Noninterest Expense

	For The Year Ended December 31,		
	1986	1987	1988
		(In thousands)	
Salaries and wages	$25,321	$25,891	$26,705
Employee benefits	5,309	6,883	7,044
Occupancy	3,543	3,758	4,218
Furniture and equipment	4,012	5,353	5,478
Printing, postage and office supplies	3,097	3,248	3,388
Marketing	1,333	1,579	1,914
Data processing	4,514	2,928	1,460
Other real estate expense	1,822	1,687	961
Other expense	8,909	7,989	8,498
Total noninterest expense	$57,860	$59,316	$59,666

Total noninterest expense in 1987 increased $1.5 million, or 2.5%, from 1986 due to the start-up in late 1986 of First American Information, an information service subsidiary which provides data processing services to the Subsidiary Banks, the continued expansion of trust services, and the restructuring and consolidation of the Company's insurance agency services. See "Business — Financial Service Subsidiaries." The investment spending required to expand, restructure, and consolidate these services was offset by reductions in other Company expenses. Increases in salary expense, which represented 43.6% of all noninterest expense in 1987, were controlled at 2.3% through the introduction of programs and systems to enhance staff efficiencies. Employee benefits increased 29.6% primarily because of an overfunded position in the Company's health plan, creating unusually low medical expense in 1986 which increased to a more normal level in 1987, and because of increased retirement and profit sharing costs. Data processing expense decreased $1.6 million primarily because of reclassifications between the years. In 1986, data processing services were contracted from outside the Company and included as data processing expense. In late 1986 and 1987, the Company established First American Information. Its expenses are all data processing related but, in the consolidation process, these detailed expenses are included in First American Information's specific expense category, such as salaries and occupancy, rather than data processing. Total data processing related expense for 1987 was $5.9 million, an increase of $600,000, or 11%, from the 1986 level, reflecting dual data processing facilities for part of 1987. Occupancy expense increased 6.1% in 1987 and furniture and equipment expense increased 33.4%, a combined increase of $1.6 million. The increase in furniture and equipment expense related to the establishment of First American Information.

Noninterest expense was $59.7 million in 1988, compared to $59.3 million in 1987. Management's continued cost consciousness held the increase in noninterest expense to less than 1%. Personnel costs, which represent 57% of all noninterest expense, increased $975,000, or 3%, while total staff size remained constant. Occupancy costs increased $460,000, or 12%, due to expansion and general price increases. Marketing expense increased $335,000, or 21.2%, reflecting the introduction of a new product line of checking accounts. These increases were offset by reductions in data processing related expense and expense related to real estate acquired through foreclosure. Data processing related expense declined $1.1 million, or 18%, from $5.9 million in 1987 to $4.8 million in 1988 because of the successful conversion in late 1987 of all the Subsidiary Banks to First American Information, eliminating the dual data processing costs that existed in 1987. The expense related to other real estate owned (OREO) declined $726,000, or 43%, reflecting the sale of OREO during 1988. OREO declined $1.4 million to $3.9 million at December 31, 1988.

Income Taxes

Income tax expense consists of provisions for federal income taxes and Minnesota, North Dakota and Wisconsin state income taxes. During recent years, the tax environment of the Company has changed significantly. With the opportunity to file a consolidated tax return in 1985, significant tax losses were taken in 1984 and 1985 as a tax planning strategy to recover previously paid federal income taxes. This was followed in 1987 by the impact of the Tax Reform Act of 1986 and the implementation of Statement of Financial Accounting Standards No. 96, Accounting for Income Taxes ("SFAS 96").

Income tax expense increased from $1.1 million in 1986 to $2.9 million in 1987 and $4.3 million in 1988 as a result of higher earnings and a lower level of tax exempt investments. These conditions were partially offset by a decrease in the federal income tax rate from 46% in 1986 to 40% in 1987 and 34% in 1988.

The Company adopted SFAS 96 in 1987. The implementation of SFAS 96 had an insignificant impact on earnings. (See Footnote J to the Consolidated Financial Statements.)

The Tax Reform Act of 1986 (the "1986 Act") contained a number of provisions that significantly affected financial institutions, including the Company. The changes enacted by the 1986 Act that had the most effect on the Company were (i) a change from the cash method of accounting to the accrual method, (ii) a loss of the reserve method of accounting for bad debts, (iii) the repeal of the investment tax credit, (iv) a change in the treatment of tax exempt obligations, (v) changes in tax rates, and (vi) changes in interest deductions for individuals.

Prior to 1987, the Company filed its tax return based on the cash basis of accounting and recorded deferred taxes on the difference between accrual basis income and cash basis income. The 1986 Act requires the Company to base its tax return on the accrual method of accounting and requires bad debts to be deducted on the specific charge-off method rather than the reserve method previously used. These changes also require the Company to recapture over a four-year period any prior amounts deferred under the cash and reserve method of accounting. These provisions will not impact federal income tax expense reported in future financial statements; however, they will accelerate the payment of taxes previously deferred. The amounts of future federal taxes payable relating to these provisions are $1.4 million, $1.3 million, $1.5 million, and $1.8 million in 1987, 1988, 1989, and 1990, respectively.

Prior to the effective date of the 1986 Act, the Company realized an average investment tax credit of 8% on fixed asset expenditures. This benefit is no longer available.

The 1986 Act had two negative effects on tax exempt obligations. First, the 1986 Act increased the interest expense disallowance of funds used to purchase tax exempt obligations after August 7, 1986 and second, the 1986 Act expanded the alternative minimum tax to include an adjustment for tax exempt interest. These effects caused the acquisition of tax exempt obligations to be less attractive by lowering the "tax equivalent" yields.

The 1986 Act also lowered tax rates, which will have a beneficial impact on future results of operations. The lower tax rates will also affect accounting for income taxes under SFAS 96, which the Company adopted in 1987. The reduced tax rates lowered the amount recorded on the balance sheet for deferred taxes. The Company has certain expenses for book purposes that are not tax deductible currently for tax purposes (such as loan loss provisions). These expenses create a deferred tax asset which continues to qualify for recognition under SFAS 96. The deferred asset must be revalued annually and can be affected by the tax rates in effect in the year of reversal.

Interest deductions by individuals are being phased out by the 1986 Act, affecting individuals who itemize their deductions. With the increase in the standard deductions, fewer individuals will be affected by this change. Interest expense on debt secured by a mortgage on a taxpayer's principal residence remains deductible. It is anticipated that eligible individuals will eliminate high-cost debt (such as finance company or credit card debt) in favor of second mortgage products. The Company believes the elimination of the individual interest expense deduction will not have a material impact on its business.

Corporate Risk Profile

Overall Risk Profile

Managing risk is an essential part of the operation of a banking organization. When risk is undertaken, the Company expects a return commensurate with the risk. If the risk profile is lowered, expectations of returns also are reduced. The Company believes its objectives of achieving consistent growth in earnings and high profitability levels will result from effectively managing and balancing the many risks involved in its business.

Generally, the Company attempts to relate the risks inherent in its business to the amount of annual net income that could be lost in the case of unanticipated and adverse developments. The Company places a high priority on containing its overall risk exposure so that a year-to-year improvement in earnings can be achieved.

Although there are many elements of risk, the three most prominent risks facing the Company are credit risk, interest rate risk, and liquidity risk. Credit risk involves the risk either of not collecting interest when it is due or of not receiving the principal balance of the loan or investment when it matures. Credit risk is the most significant risk the Company must manage. Interest rate risk is the risk to net interest income caused by differences in the repricing characteristics of assets and liabilities. Liquidity risk is the risk that the Company will not be able to fund its obligations and is largely a function of how effectively the Company manages its other risks. The Company has established policies, procedures, and constraint levels to ensure total risk positions are contained, measured accurately, monitored, and reviewed regularly by the Board of Directors of Bremer Financial. Through a coordinated effort by the management of the Subsidiary Banks and Bremer Financial, the Company believes risks are effectively controlled and managed. See "Business — Administration of Subsidiary Banks."

Credit Management

In recent years, credit quality has deteriorated for the banking industry, reflecting an economic environment that has become more volatile and uncertain. Many higher quality borrowers who traditionally relied on banks as their major funding source now use other sources, such as commercial paper issued in the financial markets or loans from automotive and mortgage finance companies.

The Company manages asset quality and controls credit risk through standard lending policies and procedures, internal loan review programs, standard loan documentation and grading procedures, and the training of lending officers. Since 1984, the Company has taken a more cautious approach toward credit extension, has had a more comprehensive monitoring and examination system, and has stressed early identification and resolution of potential problems.

The Company has adopted a standard loan policy that provides guidance and direction to assist lending personnel in the performance of their duties as well as controls to ensure adherence to prudent banking practices. See "Business — Administration of Subsidiary Banks." As part of this policy, all loans participated among Subsidiary Banks are pre-approved by either Bremer Financial's Credit Division, Participation Review Committee, or Board of Directors, depending on the size of the loan. With this policy, control is established over large loans, particularly loans in excess of the legal lending limit of an individual Subsidiary Bank.

Through a standardized loan review process implemented in 1985 and other programs, the Company continues to enhance loan administration to reduce credit risk. The internal loan review program is a tool for early identification of problem credits. Each Subsidiary Bank performs a self-analysis of its loan portfolio using standard procedures to risk rate each loan and develop a list of problem loans. When problem loans are identified, individual workout plans are developed for these loans. The reviews are submitted on a quarterly basis to the loan review department of Bremer Financial for further evaluation. The loan review staff also performs on-site examinations in certain Subsidiary Banks. In addition, assistance is provided to the Subsidiary Banks in developing workout plans for individual problem credits.

Additionally, the Company has developed and implemented standard agricultural and commercial lending procedures to assist in better analyzing the financial progress and repayment ability of borrowers. The Company also conducts annual commercial and agricultural lending workshops for Subsidiary Bank personnel that address various problems and issues in the lending area. These workshops are supplemented with formalized training programs to enhance lending skills and help further identify potential risks.

Even in the presence of rigorous programs and procedures, measuring the risk to future income from credit quality is highly subjective because many economic and noneconomic factors can influence a borrower's financial condition over extended periods of time. In evaluating credit risk, the Company takes into consideration the economic conditions under which customers operate as well as other local and regional environmental concerns, such as the uncertainties facing farmers and other agribusiness customers. Management believes that the Company's credit risk profile substantially improved in 1987 and 1988 as compared to prior years.

Loan Portfolio Review. One of the ways in which the Company reduces its credit risk is by having a loan portfolio that is well diversified by industry classification, geography, and the size and type of loan. For the past several years, commercial loans and real estate loans have comprised nearly equal portions of the loan portfolio, each comprising approximately 28% of total average loans in 1984 and continually increasing to approximately 30% in 1988. Agricultural loans comprised approximately 26% of total average loans in 1984 but decreased to 20% in 1988.

Agricultural communities have experienced severe economic difficulties and uncertainties, including the drought during the summer of 1988. The drought had minimal impact on the Company; however, the full impact cannot be determined at this time, particularly if the drought continues. As a result of these conditions, the Company is monitoring the situation very closely.

Analysis of Net Loan Charge-offs. As shown in Table VIII, net loan charge-offs increased from $11.1 million in 1984 to $20.2 million in 1985, and then declined to $13.9 million in 1986, $9.4 million in 1987, and $5.1 million in 1988. Correspondingly, net charge-offs as a percentage of average loans increased from 1.27% in 1984 to 2.18% in 1985, and then declined to 1.49% in 1986, 0.99% in 1987, and 0.52% in 1988. The Company's loss experience in 1985, which carried over to 1986, resulted partially from economic problems in the agricultural-dependent communities and partially from the lack of sound credit administration in certain Subsidiary Banks in prior years which, in management's view, has since been rectified.

TABLE VIII

Summary of Loan Loss Experience

	For the Year Ended December 31,				
	1984	1985	1986	1987	1988
	(Dollar amounts in thousands)				
Reserve for loan losses, beginning of period	$ 8,538	$ 13,244	$ 16,590	$ 17,773	$ 17,203
Charge-offs					
Commercial and other	3,937	7,822	4,564	3,459	4,606
Agricultural	5,639	9,511	8,001	5,128	1,155
Real estate —					
Mortgage	1,012	3,034	2,599	1,090	952
Construction	438	343	107	457	3
Consumer	717	706	971	1,256	699
Tax exempt	0	103	4	424	231
	11,743	21,519	16,246	11,814	7,646
Recoveries					
Commercial and other	314	607	750	921	1,002
Agricultural	128	456	992	999	1,023
Real estate —					
Mortgage	46	62	401	211	197
Construction	1	28	1	27	0
Consumer	128	164	219	278	291
Tax exempt	0	0	3	(3)	2
	617	1,317	2,366	2,433	2,515
Net charge-offs	11,126	20,202	13,880	9,381	5,131
Additions charged to operations	15,832	23,548	15,063	8,811	6,418
Balance at end of year	$ 13,244	$ 16,590	$ 17,773	$ 17,203	$ 18,490
Average loans	$879,298	$925,990	$933,714	$947,272	$984,175
Net charge-offs/average loans	1.27%	2.18%	1.49%	0.99%	0.52%

The $4.3 million, or 45%, decline in net charge-offs from 1987 to 1988 was primarily due to a $4.0 million, or 77%, decrease in agricultural charge-offs and a $557,000, or 44%, decrease in consumer charge-offs. These were offset by a $1.1 million, or 33%, increase in commercial charge-offs, which was paced by the 1988 charge-off of two commercial credits totalling $1.7 million, for which full provision had been made in prior years when the potential for loss was identified. Overall, nonperforming commercial loans have declined $4.9 million, or 50%, from 1987 to 1988.

Analysis of Nonperforming Assets. Table IX sets forth nonperforming assets at the dates indicated. Nonperforming assets include nonaccrual loans (on which interest is recorded only when received), renegotiated loans (which are renegotiated as to interest or principal), and other real estate acquired in loan settlements. The stresses on agricultural communities in the early and mid-1980s is reflected in the increased volume of nonperforming loans at that time.

TABLE IX

Nonperforming Assets

	December 31,				
	1984	1985	1986	1987	1988
	(Dollar amounts in thousands)				
Nonaccrual loans	$16,857	$33,431	$31,517	$17,235	$10,217
Restructured loans	2,370	6,452	6,603	7,404	7,265
Total nonperforming loans	19,227	39,883	38,120	24,639	17,482
Other real estate	2,979	4,152	6,553	5,304	3,895
Total nonperforming assets	$22,206	$44,035	$44,673	$29,943	$21,377
Accruing loans 90 days past due	$12,875	$10,687	$ 6,383	$ 4,047	$ 4,054
Nonperforming loans to total loans	2.11%	4.31%	4.09%	2.56%	1.70%
Nonperforming assets to total assets	1.48	2.82	2.77	1.84	1.25
Reserve for loan losses to nonperforming loans	68.88	41.60	46.62	69.82	105.77

Nonperforming loans at December 31, 1984 were $19.2 million, increased to $39.9 million at December 31, 1985, declined to $38.1 million at December 31, 1986 and $24.6 million at December 31, 1987, and further declined to $17.5 million at December 31, 1988. Nonperforming loans represented 4.1% of total loans at December 31, 1986, 2.6% at December 31, 1987, and 1.7% at December 31, 1988. Nonperforming assets as a percent of total assets were 2.8%, 1.8%, and 1.3% at December 31, 1986, 1987, and 1988, respectively. Comparing nonperforming assets from 1987 to 1988, those secured by real estate increased from 32% of the total to 41%, agricultural loans increased from 31% to 32%, and commercial loans declined from 33% to 23%.

The Company reviews the adequacy of its reserve for loan losses by, among other things, monitoring the ability of the reserve to cover identified nonperforming loans. This coverage has improved significantly since 1985 due to the variety of steps taken to improve credit quality. The ratio of the reserve for loan losses to nonperforming loans was 46.6%, 69.8%, and 105.8% at December 31, 1986, 1987, and 1988, respectively. Loans now current where there are serious doubts as to the ability of the borrower to comply with the present loan repayment terms are not significant.

For 1986, net interest income was reduced approximately $3.8 million from the effect of nonperforming loans, compared to reductions of $2.6 million in 1987 and $1.7 million in 1988. Loans are placed on nonaccrual when principal or interest are past due ninety days or more, unless the loan is both well secured and in the process of collection.

Analysis and Allocation of Reserve for Loan Losses. The purpose of the reserve for loan losses is to provide for future loan losses inherent in the Company's loan portfolio. The reserve is increased by the provision for loan losses and recoveries of loans previously charged off and decreased by charge-offs. Although the adequacy of the reserve is judgmental, it is based on a continual evaluation of the loan portfolio, economic conditions and expectations, historical experience, and the riskiness of individual loans. As shown in Table X, at December 31, 1986 the reserve for loan losses was $17.8 million, or 1.9% of outstanding loans, compared with $17.2 million, or 1.8% of outstanding loans, at December 31, 1987 and $18.5 million, or 1.8% of outstanding loans, at December 31, 1988. Table X sets forth information regarding the allocation of the loan loss reserve to total loans outstanding by loan type, the composition of the loan portfolio, and the reserve as a percent of total loans outstanding, at the dates indicated.

TABLE X

Reserve Allocation

	December 31,									
	1984		1985		1986		1987		1988	
	% of Total Loans	Reserve Allocated	% of Total Loans	Reserve Allocated	% of Total Loans	Reserve Allocated	% of Total Loans	Reserve Allocated	% of Total Loans	Reserve Allocated
	(Dollar amounts in thousands)									
Commercial and other	28.51%	$ 4,700	29.65%	$ 4,600	31.07%	$ 5,200	31.60%	$ 7,700	32.67%	$ 7,200
Agricultural	23.52	5,700	20.14	8,000	20.50	5,200	19.32	4,100	18.71	4,100
Real estate —										
Mortgage	28.03	1,800	29.23	2,600	27.83	2,700	29.36	1,500	28.74	1,500
Construction	.46	200	.60	100	1.31	400	1.23	100	1.46	100
Consumer	13.43	400	13.34	1,000	12.81	1,700	12.48	800	12.88	1,000
Tax exempt	6.05	100	7.04	—	6.48	700	6.01	200	5.54	400
Total allocated		12,900		16,300		15,900		14,400		14,300
Unallocated		344		290		1,873		2,803		4,190
Total	100.00%	$13,244	100.00%	$16,590	100.00%	$17,773	100.00%	$17,203	100.00%	$18,490
Reserve to total loans		1.45%		1.79%		1.90%		1.78%		1.80%

The reserve for loan losses maintained by the Company is a general allowance available to cover future losses within the entire loan portfolio. However, management has prepared an allocation of the allowance based on its views as to the risk characteristics of the portfolio. The reserve allocation does not represent the total amount available for actual future loan losses in any single category nor does it prohibit future loan losses from being absorbed by portions of the reserve allocated to other categories or by the unallocated portion.

The allocation of the reserve for loan losses is primarily based on the results of the Company's loan review efforts where loans having more than normal risk are evaluated for exposure to loss. At the end of each quarter, management reviews reserve adequacy based on the status of problem loans, economic conditions, and industry concentrations. Particular attention is given to the amount of additional minimum exposure identified for specific industry segments, which might suggest developing trends of credit quality concerns. See "Business — Lending Policies, Practices, and Procedures."

Interest Rate Sensitivity Management

Asset and liability rate sensitivity management is related to liquidity management and has become increasingly important with the deregulation of deposit rates. The prime objective of the asset/liability process is to maintain an appropriate balance between the stability of net interest income and the risks associated with significant changes in market interest rates. The responsibility for this process rests with each Subsidiary Bank's asset/liability committee (the "ALCOs"). Together, the ALCOs and the financial staff of Bremer Financial establish asset/liability policies and develop strategies to minimize Company-wide exposure to adverse interest rate trends. See "Business — Administration of Subsidiary Banks."

Interest rate sensitivity risk is the risk that changing interest rates will adversely affect net interest income. While certain levels of interest rate sensitivity risk are unavoidable, and even may be desirable, it is important to measure and manage this risk as closely as possible to ensure that it does not reach levels that are unacceptable. Interest rate sensitivity is determined by the amount of assets and liabilities repricing or maturing within a specified time period. A tool for measuring the interest rate sensitivity is the gap analysis presented with Table XI, which sets forth information at December 31, 1988 regarding interest rate sensitivity gaps for assets and liabilities.

TABLE XI
Interest Rate Sensitivity Gaps

	Repricing Maturities At December 31, 1988		
	One Year or Less	More Than One Year	Total
	(Dollar amounts in thousands)		
Interest sensitive assets			
Loans	$ 591,398	$435,186	$1,026,584
Investments	178,118	343,978	522,096
Other earning assets	34,837	343	35,180
Total interest sensitive assets	$ 804,353	$779,507	$1,583,860
Interest sensitive liabilities			
Deposits excluding certificates	$ 257,983	$309,318	$ 567,301
Certificates of deposit	617,084	211,997	829,081
Short term borrowings	58,186	75	58,261
Long term debt	557	3,458	4,015
Total interest sensitive liabilities	$ 933,810	$524,848	$1,458,658
Repricing gap	$(129,457)	$254,659	
Cumulative repricing gap	(129,457)	125,202	
Cumulative gap to total assets	(7.60)%	7.35%	

Gap reports assign each asset and liability to a time interval based on maturity or next repricing date, whichever comes first. The difference between assets and liabilities in each interval represents the interest rate sensitivity gap. A positive gap generally means that rising rates during the given time interval will positively affect net interest income. The opposite is generally true for a negative gap.

Interest rate sensitivity varies with different types of interest earning assets and interest bearing liabilities. Overnight federal funds on which rates change daily and loans which are tied to the prime rate are considerably more interest sensitive than long-term investment securities and fixed-rate loans. Similarly, certificates of deposit are more interest sensitive than savings accounts. The shorter term interest rate sensitivities are the key to measuring the interest sensitivity gap, or the relationship of interest sensitive earning assets to interest bearing liabilities. To manage more effectively this product-by-product impact on interest rate risk, management has implemented a Company-wide standard pricing methodology which allows the Subsidiary Banks to set interest rates based on a relationship to Treasury yield curve rates and repricing frequencies on their products in light of their local market and particular balance sheet structure. See "Business — Administration of Subsidiary Banks."

The gap analysis assumes a simultaneous price change on both assets and liabilities when market interest rates move. In practice, however, interest rates on assets and liabilities do not change immediately or at the same velocity. Historically, the Company has lagged behind national interest rate movements. During 1988, interest rates rose and the Company became more interest sensitive on liabilities, which is reflected in a larger negative gap. At the same time, however, both net interest income and the net interest margin remained stable when adjusted for noninterest sensitive items, such as loan fees, nonaccruing loans, and the tax equivalent factor.

As of December 31, 1988, the Company's interest sensitivity gap within one year was a negative $129 million. This compares to a negative gap at December 31, 1987 of $43 million. The increase in the negative gap, resulted from shifts by the Company to longer maturities for investment securities and shifts by depositors to shorter term accounts, such as Super NOW checking accounts and certificates of deposit less than $100,000, from savings and NOW accounts. Management feels this change is well within acceptable interest rate risk restraints.

Interest rate risk restraints are quantified by the ratio of gap to total assets, which represents the percentage of total assets exposed to interest rate risk. This ratio within the one-year time frame was a negative 3.3% at December 31, 1986, a negative 2.6% at December 31, 1987, and a negative 7.6% at December 31, 1988. However, within the time frame of one year, there are many repricing opportunities that provide management the flexibility to change prices should interest rates change significantly.

Liquidity Management

The objective of liquidity management is to ensure the continuous availability of funds to meet the demand of depositors, investors, and borrowers. The ALCOs are responsible for managing balance sheet and off-balance sheet commitments to meet the needs of customers while achieving the Company's financial objectives. ALCOs meet regularly to review funding capacity, current and forecasted loan demand, and investment opportunities. With this information, the ALCOs guide changes in the balance sheet structure to provide adequate liquidity.

Several factors provide a favorable liquidity position for the Company. The first is the large amount of funding that comes from core deposits (consisting of all deposits except certificates of deposit in denominations of $100,000 or more), which are a more stable source of funding than purchased funds. The ability to retain and acquire new deposits is essential. The Company has a high proportion of core deposits to total liabilities; this index was 86% in 1985 through 1988. A secondary source of liquidity is the Company's securities portfolio.

The Subsidiary Banks' ability to pay dividends to the Company, the Company's ability to pay dividends to holders of the Class A Common Stock and Class B Common Stock, and the ability of the Subsidiary Banks to loan funds to the Company, are restricted and limited by regulation. See "Supervision and Regulation."

Balance Sheet Analysis

The Company's balance sheet strength, from a funding perspective, has been its ability to maintain substantial volumes of free funds, capital, and noninterest bearing deposits to fund earning assets. This trend has continued even after the deregulation of interest rates on deposits, which has increased the customers' awareness of interest rate opportunities. While the Subsidiary Banks have little influence over the investment choices of customers, the deposit options are priced competitively.

Sources of Funds

The Company relies on five major sources of funding: capital funds, long-term debt, short-term borrowings, interest bearing deposits, and noninterest bearing deposits. The diversity and stability of this funding base enables the Company to replace maturing liabilities and finance asset growth on an ongoing basis. (For a discussion of the Company's capital position, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Performance Overview — Balance Sheet Summary.")

Table XII sets forth a summary of the average daily amount of deposits and rates paid on such deposits for the years indicated:

TABLE XII

Deposits

	For the Year Ended December 31,					
	1986		1987		1988	
	Balance	Rate	Balance	Rate	Balance	Rate
	(Dollar amounts in thousands)					
Savings and NOW accounts	$ 185,648	5.00%	$ 219,779	4.71%	$ 208,966	4.53%
Money market checking	68,982	5.06	78,100	4.63	85,339	4.73
Money market savings	167,220	5.52	172,264	4.98	159,879	5.21
Savings certificates	650,135	8.07	625,271	6.91	671,935	7.01
Certificates over $100,000	99,881	7.12	110,191	6.52	116,626	7.20
Total time deposits	1,171,866		1,205,605		1,242,745	
Noninterest bearing deposits	161,667		165,133		161,469	
Total deposits	$1,333,533		$1,370,738		$1,404,214	

Table XIII sets forth the remaining maturities of time certificates of deposit of $100,000 or more at the dates indicated:

TABLE XIII

Maturity of Time Certificates of Deposit

	Time Certificates Over $100,000 at December 31, 1987	Time Certificates Over $100,000 at December 31, 1988
	(In thousands)	
Three months or less	$ 62,095	$ 73,781
Over 3 through 6 months	25,280	21,892
Over 6 through 12 months	19,627	16,947
Over 12 months	5,581	9,281
Total	$112,583	$121,901

Average interest bearing liabilities as a percentage of average interest earning assets decreased from 85.5% in 1987 to 85.3% in 1988. Improved asset utilization and increased equity contributed to this decrease.

Long-term debt provides greater than one-year funding for the Company. Average long-term debt declined from $5.5 million in 1987 to $5.1 million in 1988.

Average short-term borrowings, which include federal funds purchased, securities sold under agreements to repurchase, and treasury tax and loan notes, increased 15% from $57.2 million in 1987 to $65.8 million in 1988. Most of the growth can be attributed to an increase in repurchase agreements, which are typically used for deposits by public entities (such as cities, counties and school districts). Repurchase agreements provide a greater profit potential on public funds, since the costs associated with issuing repurchase agreements are less than the costs associated with issuing other deposit vehicles.

Table XIV sets forth the distribution of short-term borrowings and the weighted average interest rates for the years indicated and the maximum amount of borrowings for those same years:

TABLE XIV

Short-Term Borrowings

	Federal Funds and Repurchase Agreements(1)	Treasury, Tax and Loan Notes(2)	Other Short-term Borrowings
	(Dollar amounts in thousands)		
Balance at year-end			
December 31, 1986	$57,799	$4,210	$ 9,700
December 31, 1987	46,763	4,590	5,000
December 31, 1988	53,794	4,467	—
Weighted average interest rate at year-end			
December 31, 1986	5.82%	5.21%	7.64%
December 31, 1987	6.16	8.26	7.52
December 31, 1988	7.61	8.21	—
Maximum amount outstanding at any month-end			
1986	$57,799	$9,404	$17,258
1987	68,307	12,340	9,700
1988	80,870	9,492	5,000
Average amount outstanding during the year			
1986	$49,933	$4,193	$13,663
1987	45,520	5,610	6,045
1988	58,871	4,656	2,500
Weighted average interest rate during the year			
1986	6.30%	6.68%	7.20%
1987	5.92	6.67	7.41
1988	6.81	7.17	8.32

(1) Federal funds and repurchase agreements generally mature within one to four days of the transaction date.

(2) Treasury, tax and loan notes generally mature within one to thirty days.

Interest bearing deposits include certificates of deposit, savings certificates, and money-market checking and savings products. These average deposits increased $37.1 million, or 3.1%, to $1.24 billion in 1988.

Average noninterest bearing deposits, the majority of which are from corporate sources, decreased $3.6 million, or 2.2%, in 1988, for an average balance of $161.5 million in 1988.

Average total deposits increased $33.5 million, or 2.4%, to $1.40 billion in 1988. Deposit growth has been adversely affected by the economies in some of the Company's markets. In response, marketing programs and strategies have been implemented to increase the Company's market share. See "Business — Subsidiary Banks." A new line of checking accounts was introduced in mid-1988 which, in the first six months, resulted in over 5,000 new deposit relationships, for a $7.7 million increase in core deposits.

During 1987, there was a movement toward interest sensitive deposits and away from fixed maturity instruments, as customers expressed uncertainty about interest rates. In contrast, the 1988 environment of generally rising interest rates has prompted depositors to shift into fixed rate deposits (such as savings certificates) from variable rate deposits (such as savings, NOW, and money market accounts). Comparing averages for 1988 to 1987, variable rate deposits decreased 3.4%, while fixed rate deposits increased 7.2%.

Uses of Funds

Total average assets increased $54.0 million, or 3.4%, in 1988. During the same time, average earning assets grew $56.0 million, or 3.8%. This level of growth reflects the constraints of the current economy in the predominately rural markets served. During 1988, growth in total average assets was 7.5% for the eight banking communities having the strongest growth. The mix of earning assets has remained stable over the years compared.

Loans. Overall loan demand in the Company's markets was weak in 1987; however, this condition improved during 1988 for a 3.9%, or $37.0 million, increase over 1987. The stronger growth during 1988 was reflected in consumer, real estate, commercial and agricultural loans, with increases of 6.3%, 6.2%, 3.8%, and 1.8%, respectively. Average tax exempt loans decreased 4.7% from 1987 to 1988 as a result of the diminished benefits of holding tax exempt assets due to the 1986 Act.

Table XV sets forth outstanding loans at the dates indicated:

TABLE XV

Loan Portfolio

	December 31,				
	1984	1985	1986	1987	1988
			(In thousands)		
Commercial and other	$260,712	$275,043	$290,325	$304,779	$ 335,391
Agricultural	215,140	186,795	191,510	186,322	192,054
Real estate —					
Mortgage	256,358	271,107	260,085	283,113	295,022
Construction	4,213	5,576	12,224	11,879	14,937
Consumer	122,849	123,722	119,709	120,399	132,277
Tax exempt	55,314	65,258	60,530	57,930	56,903
Total	$914,586	$927,501	$934,383	$964,422	$1,026,584

Table XVI sets forth the maturity distribution of loans at December 31, 1988:

TABLE XVI

Loan Maturities

December 31, 1988

	Maturing:			
	Within One Year	After One But Within Five Years	After Five Years	Total
		(In thousands)		
Commercial and other	$155,800	$120,512	$ 59,079	$ 335,391
Agricultural	120,944	49,022	22,088	192,054
Real estate —				
Mortgage	45,188	133,363	116,471	295,022
Construction	8,987	896	5,054	14,937
Consumer	62,904	65,143	4,230	132,277
Tax exempt	13,326	15,769	27,808	56,903
Total	$407,149	$384,705	$234,730	$1,026,584
Loans maturing after one year				
Fixed interest rate		$258,736	$132,388	
Variable interest rate		125,969	102,342	
		$384,705	$234,730	

Investment Securities. The Company's investment portfolio contributes substantial interest revenues from securities issued by the United States Treasury, federal agencies, state governments, and municipalities. During 1988, average total investment securities increased $22.0 million, or 4.5%. Average investment securities comprised 32.9% of earning assets in 1987, compared to 33.2% in 1988. The average maturity of the portfolio was twenty-three months at December 31, 1987, with a weighted average yield to maturity of 8.5%. This compares to an average maturity of thirty months at December 31, 1988, with a weighted average yield to maturity of 8.8%.

Table XVII sets forth the carrying amount of investment securities at the dates indicated:

TABLE XVII

Investment Portfolio

	December 31,		
	1986	1987	1988
		(In thousands)	
Government and agencies	$342,895	$287,756	$268,211
State and political subdivisions	75,995	67,391	63,791
Collateralized mortgage obligations	62,000	106,050	102,438
Other taxable securities	2,256	19,639	87,656
	$483,146	$480,836	$522,096

Table XVIII sets forth the maturities of investment securities at December 31, 1988 and the weighted average yields of such securities (calculated on the basis of cost and effective yields weighted for the scheduled maturity of each security). Tax equivalent adjustments (using a 34% rate) have been used in calculating yields on obligations of state and political subdivisions. The placement of mortgage-backed securities in the maturity schedule is based on the average life of the investment, which is shorter than stated maturity due to principal repayments, which are predictable.

TABLE XVIII

Investment Maturities

December 31, 1988

	Maturing:							
	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
			(Dollar amounts in thousands)					
Government and agencies	$123,381	7.82%	$144,830	8.25%	$ —	—%	$ —	—%
State and political subdivisions	7,418	11.11	31,899	11.97	23,404	11.91	1,070	13.82
Collateralized mortgage obligations	21,512	8.75	78,877	8.75	2,049	8.74	—	—
Other taxable securities	27,153	8.78	45,322	8.80	14,076	9.07	1,105	8.62
	$179,464	8.22	$300,928	8.86	$39,529	10.73	$2,175	11.18

At December 31, 1987, the market value of the Company's investment securities was $482.4 million, or $1.6 million over the recorded value, compared to a market value of $515.6 million, or $6.5 million under the recorded value, at December 31, 1988. The unrealized gain at December 31, 1987 was due to the market-wide depression of interest rates caused by the stock market crash of October 19, 1987; the securities held by the Company had higher than market yields resulting in an unrealized market gain. In contrast, 1988 was characterized by generally rising interest rates, predominantly on shorter term maturities. This caused an unrealized market loss on the Company's investment securities, the majority of which have maturities of less than five years and yields below market.

As a result of weak loan demand, investment portfolio earnings have become increasingly important to the Company in recent years, prompting the implementation of new programs. Beginning in 1986, the Company centralized the administration of the Subsidiary Banks' portfolios. See "Business — Administration of Subsidiary Banks." Through this restructuring process, the Company pooled its resources, thereby opening investment opportunities that had not previously existed. One such opportunity was collateralized mortgage obligations. These securities were an attractive investment because of the favorable spreads as compared to Treasury securities, the AAA credit ratings, and the reasonably predictable rate of prepayment. Collateralized mortgage obligations were 22.1% of the Company's total investment securities at December 31, 1987, compared to 19.6% at December 31, 1988.

Average tax exempt investments typically earn tax equivalent interest higher than taxable investments. The 1986 Act greatly reduced the advantages of owning tax exempt investments. These investments, which decreased 8.2% in 1988, have been replaced by taxable earning assets.

Impact of Inflation

The assets and liabilities of a financial institution are primarily monetary in nature. As such, they represent obligations to pay or receive fixed and determinable amounts of money which are not affected by future changes in prices. During periods of inflation, monetary assets lose value in terms of purchasing power while monetary liabilities have corresponding purchasing power gains. Because banks generally have an excess of monetary assets over monetary liabilities, inflation, in theory, will cause a loss of purchasing power in the value of shareholder's equity. Purchasing power may be misleading because it does not take into account changes in interest rates, which are the greatest determinant of bank earnings. The portion of this Prospectus entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations — Corporate Risk Profile — Interest Rate Sensitivity Management" provides the information necessary for an understanding of the Company's ability to react to changing interest rates.

BUSINESS

General

The Company is a regional multi-state bank holding company headquartered in St. Paul, Minnesota, and incorporated under Minnesota law on December 7, 1943. The Company owns at least 81% of the outstanding capital stock of the twenty-five Subsidiary Banks. The Company owns all of the outstanding capital stock of First American Trust Company of Minnesota ("First American Trust"), which provides trust and other fiduciary services to most of the Minnesota Subsidiary Banks' communities; Bremer Financial Services, Inc. ("Bremer Financial"), which provides management and support services to the Company and its subsidiaries; First American Information Services, Inc. ("First American Information"), which provides data processing services to the Subsidiary Banks; and the two First American Insurance Agencies, Inc. (the "Insurance Agencies"), one of which is a Minnesota corporation and one of which is a North Dakota corporation and which provide insurance agency services in the Subsidiary Banks' communities. The Company also owns a controlling portion of the capital stock of Bremer First American Life Insurance Company. See "Business — Financial Service Subsidiaries." As a bank holding company, the Company's principal business is owning and managing the Subsidiary Banks, Bremer Financial, First American Information, First American Trust, and the Insurance Agencies.

The Company operates under a management philosophy of local market decision-making by each Subsidiary Bank within corporate policies and procedures. Through a formal strategic planning process, which is conducted at both the Company and the subsidiary levels, ideas are exchanged and melded into a common direction for the entire organization. Every effort is made to support local management with ideas and resources that being part of a larger organization offers. In addition, operations are streamlined and consolidated to take advantage of the efficiencies offered by a multi-bank organization.

Bremer Financial provides the management function for the Company and a broad range of management services to the individual subsidiaries in order to augment the capabilities of the subsidiaries' management and expand the variety of products each Subsidiary Bank can offer to its customers. Services provided by Bremer Financial and the other financial service subsidiaries involve specialized knowledge and skills in numerous areas of bank policy and operations, including accounting controls and reporting; profit planning; strategic planning; auditing; asset/liability management; data processing and automation; credit and loan analysis; loan review and examinations; investments; tax planning and compliance; equipment planning; marketing, market research and product design; employee benefit programs; personnel management; and training and trust services.

The basic philosophy, however, is to keep the decision-making as close to the marketplace as possible. Each Subsidiary Bank is a separate corporation with its own officers and board of directors and is committed to being a well-managed, profitable community bank. Each provides a full range of bank services to its community and is committed to contributing to the economic and social environment of its community.

Subsidiary Banks

The twenty-five Subsidiary Banks are located in Minnesota, Wisconsin and North Dakota and have a total of 47 offices throughout these states. They range in size from $14.3 million to $221.1 million in total assets and $12.6 million to $188.6 million in total deposits as of December 31, 1988. Each of the Subsidiary Banks is a community bank that provides a full range of commercial and consumer banking services to individuals, businesses, industry, institutional organizations, governmental entities, and other financial institutions. Depository services include checking accounts, savings accounts, and time certificate contracts. The Subsidiary Banks' services include the acceptance of savings and checking deposits and the making of commercial, real estate, agricultural, personal and other installment and term loans. The Subsidiary Banks draw most of their deposits from and make substantially all of their loans within the states of Minnesota, Wisconsin, and North Dakota and have no foreign loans.

The Subsidiary Banks have a common commitment to quality services and strive to provide services that exceed customers' expectations. They are building a comprehensive sales organization focusing on opportunities to develop multiple relationships with existing customers. The goal is to provide customers with as many of each Subsidiary Bank's financial services as the customers' needs may dictate. Each of the Subsidiary Banks is committed to build upon a sales and services philosophy and strives to maintain a strong market presence in the trade area it serves. Bremer Financial augments the individual marketing efforts of the Subsidiary Banks through common product development, market research, sales training, and assistance in setting and achieving sales performance goals. Through this coordinated effort, along with the local identity fostered through community involvement, the Subsidiary Banks are able to compete effectively in the markets they serve.

The names, locations, total assets, and total deposits as of December 31, 1988 of each of the Subsidiary Banks and the populations of the communities in which they are located are set forth below:

Names and Locations of Subsidiary Banks	Assets at December 31, 1988 (in thousands)	Deposits at December 31, 1988 (in thousands)	Trade Area Population (1988 Estimate)*
Minnesota:			
First American Bank of Alexandria	$101,400	$ 83,000	10,800
First American Bank of Brainerd	88,600	81,200	20,700
First American Bank of Breckenridge	42,700	35,100	13,900
First American National Bank of Crookston	128,500	113,000	9,600
First American Bank of Detroit Lakes	83,800	72,500	7,700
First American Bank of International Falls	51,600	47,000	7,900
First American Bank of Marshall	70,500	57,500	14,200
First American Bank of Redwood Falls	35,500	28,700	5,000
First American National Bank of St. Cloud	221,100	188,600	179,000
Drovers First American Bank of South St. Paul	144,800	121,300	67,000
First American Bank of Warren	33,200	30,100	3,800
First American Bank of Watertown	20,500	18,600	2,000
First American Bank of Willmar	106,800	90,200	21,200
North Dakota:			
First American Bank & Trust of Carrington	55,000	51,100	3,600
First American Bank of Casselton	31,700	28,500	3,400
First American Bank & Trust of Grafton	87,200	78,300	6,400
First American Bank of Larimore	24,800	21,500	6,300
First American Bank of Lisbon	42,700	37,000	2,100
First American Bank of Minnewaukan	14,300	12,600	400
First American Bank & Trust of Minot	121,200	106,100	49,900
First American Bank of Richardton	18,300	16,000	800
First American Bank of Rugby	29,000	26,000	4,800
Wisconsin:			
First American Bank of Amery	77,700	66,700	3,900
First American Bank of Frederic	43,500	39,000	4,800
First American Bank of Apostle Islands	35,000	28,400	3,500

* Each Subsidiary Bank identifies its own trade area, which is the area in which the Subsidiary Bank obtains the majority of its business. 1988 Population Estimates were provided by National Planning Data Corporation.

The Subsidiary Banks' Communities

Fifteen of the Subsidiary Banks (the "Agricultural Banks") are located in predominantly agricultural areas and have more than 25% of their loan portfolio in agricultural or agricultural related loans. These Subsidiary Banks accounted for 69% of the Subsidiary Banks' average agricultural loans in 1988. The Agricultural Banks as a group have had a significant impact on the Company's results over the last four years. Their earnings or losses for the years ended December 31, 1985, 1986, 1987 and 1988 were a loss of $3.1 million and earnings of $1.9 million, $4.8 million and $6.3 million, respectively.

The Agricultural Banks' earnings have been affected by the distressed agricultural markets they serve. In 1985, the Agricultural Banks accounted for 70.1% of consolidated net charge-offs, declining to 66.1% in 1986 and 26.8% in 1987 and rising to 45.1% in 1988. The 1988 net charge-offs were adversely affected by one Agricultural Bank that accounted for 74% of the Agricultural Banks' charge-offs. The increase in net charge-offs for that Agricultural Bank was due to two commercial loans. Excluding this Agricultural Bank, the adjusted net charge-offs for the Agricultural Banks were 11.9% of the consolidated net charge-offs for 1988. The positive trend the Agricultural Banks have experienced is consistent with the improved earnings of the entire Company.

Three of the four largest Subsidiary Banks — First American National Bank of St. Cloud, Drovers First American Bank of South St. Paul, and First American Bank & Trust of Minot — are located in cities within regional hub centers or major metropolitan areas having trade area populations in excess of 45,000 people. The third largest Subsidiary Bank, First American National Bank of Crookston, is an Agricultural Bank that is located in the Red River Valley, one of the best agricultural areas in the Upper Midwest. First American National Bank of Crookston is the largest financial institution in its trade area. Four of the Subsidiary Banks are located in resort communities and serve the needs of various recreational industries. Eighteen of the twenty-five communities in which the Subsidiary Banks are located are county seat locations with the attendant government and service offices. Eleven of the Subsidiary Banks are located in communities which include universities, colleges or vocational schools.

All but two of the Subsidiary Banks' communities have populations in excess of 2,000 people. The Company believes the Subsidiary Banks' communities will continue to be viable communities due to a trend toward consolidation of the rural population and businesses. The Company estimates that the population of its Subsidiary Banks' communities will grow at an average rate of 6.4% over the next five years, which is consistent with historical trends. Seven communities, all of which are Agricultural Bank communities, are projecting population declines; the remaining Subsidiary Bank communities are projecting an average population growth of approximately 7.4% over the next five years. Management of the Company believes these communities will continue to provide a stable base of relatively low-cost deposits for the Subsidiary Banks. Where a particular community is not large enough or does not produce sufficient business to adequately support a Subsidiary Bank, the Company has merged such Subsidiary Bank with another Subsidiary Bank located in the same area. Specifically, in December 1984, the Company merged First American Bank of Crookston and State Bank of Shelly, Minnesota state banks, into The First National Bank of Crookston, and First American Bank of Colfax into First American Bank of Amery, both of which are Wisconsin state banks. In August 1986, the Company merged First American Bank of Brandon into First American Bank of Alexandria, both of which are Minnesota state banks. Effective April 1, 1989, the Company also merged First American Bank of Redwood Falls into First American Bank of Marshall, which are Minnesota state banks.

Lending Policies, Practices, and Procedures

The Company intends to maintain high credit quality by observing consistent lending practices that it believes to be conservative.

Credit policies and procedures of the Subsidiary Banks have changed substantially beginning in 1984. The Company has adopted standard lending procedures and has developed an internal loan review system, standard loan documentation and grading procedures, along with providing extensive training for all lending officers. The Company believes that with the instigation of these policies, procedures, and practices, overall loan quality has improved.

Extensive emphasis is placed on agricultural lending procedures, practices, and the education of lending personnel. The Company believes it has enhanced its credit approval and monitoring process for agricultural loans primarily because the focus is now placed on the ability of the borrower to repay as opposed to the historical practice of focusing on the value of the assets collateralizing the loans. The Company is committed to agribusiness and continues to seek quality operations to which to extend credit.

The Company implemented a standard loan review system in 1984. The purpose of the loan review system is twofold; one, to provide an early warning system to identify potential problem loans and, concurrently, to develop action plans to remedy the deficiencies noted; and two, to assist Subsidiary Banks in determining the adequacy of their reserves for loan losses. Loans are reviewed periodically depending upon their size and risk characteristics, and a credit risk rating is assigned to each loan reviewed.

The cornerstone of the Company's review process is the lending officer, who assigns the initial risk rating to loans. These ratings are then independently verified at the Subsidiary Bank level by the credit review officer who, in addition to such independent verification, summarizes the results and presents these results to the Board of Directors of the Subsidiary Bank. These reviews and ratings are then forwarded to the Credit Review Department of Bremer Financial, whose role is to verify the loan's risk rating and assure that the reviews are being done on a consistent basis within the Company's prescribed parameters and procedures. Quarterly reports are summarized and the adequacy of the reserve for loan loss is determined on a combined basis for all Subsidiary Banks. The Company believes this coordinated effort among the Subsidiary Banks and Bremer Financial identifies problem loans on a timely basis and minimizes risk.

Administration of Subsidiary Banks

Bremer Financial provides the management function for the Company and provides a broad range of services to the individual subsidiaries in order to augment the capacities of the subsidiaries' management. Each Subsidiary Bank reports to a Region President, who provides consultation and advice to the Subsidiary Banks, approves profit plans and strategic plans, and monitors performance. See "Management." In addition to the direct reporting relationship with the Subsidiary Banks, the Region Presidents are on the Company's corporate planning team and Bremer Financial's Board of Directors, thereby providing a communications link between the Subsidiary Banks and the Company. The Company provides to the Subsidiary Banks the overall guidelines, policies, and procedures, as well as certain technical staff support, while granting autonomy to each Subsidiary Bank's management with respect to day-to-day operations and community relations. It is through this coordinated effort among the Subsidiary Banks, the Region Presidents and the staff of Bremer Financial that the Company is able to achieve its desired results.

The major areas of policy direction and coordination established by the Company for the Subsidiary Banks include the following:

Credit. The Company has established a standard credit policy, standard loan review system, and standard loan documentation procedures. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Corporate Risk Profile — Credit Management" and "Business — Lending Policies, Practices, and Procedures." The Credit Division of Bremer Financial assists the Subsidiary Banks in structuring loans and in developing workout plans for problem loans, approves loans of up to a specific amount (presently $1.0 million) for participation among the Subsidiary Banks, and is responsible for developing and recommending credit policies and procedures.

The following is a synopsis of the loan approval process:

- Each Subsidiary Bank's Board of Directors establishes lending authorities for its lending officers and loan committees. Each Subsidiary Bank has the authority to make loans in amounts up to its applicable legal lending limit. The Subsidiary Banks' legal lending limits range from $220,000 to $3.2 million.
- Any loan that is participated among Subsidiary Banks is subject to approval by Bremer Financial's Credit Division, Participation Review Committee, or Board of Directors, depending on the size of the loan. A loan is participated when an extension of credit to one borrower exceeds an individual Subsidiary Bank's legal lending limit, and the amount of the loan in excess of the lending limit is participated out or sold to another Subsidiary Bank. The loan must be approved by the appropriate authority within the Subsidiary Bank prior to being submitted to Bremer Financial. The Subsidiary Banks together could facilitate a $22.6 million credit using the full legal lending limit authority of each Subsidiary Bank. The largest loan to one borrower participated among the Subsidiary Banks that was outstanding as of December 31, 1988 was approximately $7.1 million.
- Bremer Financial's Participation Review Committee consists of four of the most senior lending personnel of the Subsidiary Banks and the Vice President of Credit of Bremer

Financial. The Credit Division approves loans up to a specific amount (currently up to $1 million), which are then approved by the Committee. The Committee reviews and approves all participated loans in amounts within a certain range (currently more than $1 million but less than $5 million). The Committee also reviews and recommends to the Bremer Financial Board of Directors loans in excess of a certain amount (currently $5 million), which are then reviewed and approved by the Board of Directors.

Asset/Liability Management. Asset/liability management is the process of defining, measuring and monitoring interest rate risk to achieve an optimum balance between interest rate risk and net income. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Corporate Risk Profile — Interest Rate Sensitivity Management." The Company recognizes that the asset/liability management process is critical to its success and actively monitors the relationship between interest rate levels and repricing characteristics and maturities of its interest earning assets and interest bearing liabilities.

Bremer Financial establishes asset/liability policies, develops a standard methodology which establishes prices based upon relationships to Treasury yields, and coordinates the monitoring of interest rate risk for the entire organization. Each Subsidiary Bank also addresses asset/liability management through its asset/liability committee, which has the primary responsibility for the Subsidiary Bank's asset/liability management within the policies established by Bremer Financial. Each Subsidiary Bank establishes its own asset/liability pricing based upon local market conditions and the methodology established by Bremer Financial.

This combined effort of individual subsidiary pricing and standard measuring of interest rate risk within corporate policies has allowed the Company to produce consistent net interest income within the Company's acceptable interest rate risk. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Income Statement Analysis — Net Interest Income."

Investments. Since 1986, all of the investment portfolio securities of the Subsidiary Banks have been managed by the Investment Department of Bremer Financial. The Board of Directors of Bremer Financial is responsible for approval of the investment policy, strategy formation, and the monitoring of investment performance. The implementation of investment strategy is coordinated with the Subsidiary Banks to meet their individual liquidity and funding needs. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Uses of Funds — Investment Securities."

Finance. Bremer Financial has established policies for capital expenditures, accounting policy, capital adequacy and dividends. In addition, its Finance Division monitors the performance of the Company's individual subsidiaries and coordinates the reporting process, the strategic planning process, and annual profit planning.

Human Resources. The Human Resources Division of Bremer Financial has established standard salary administration procedures, and the Subsidiary Banks administer these at the Subsidiary Bank level. Employee benefits are standardized and administered by Bremer Financial.

Auditing. Bremer Financial has an internal audit department which conducts periodic audits and internal control reviews of all Subsidiary Banks.

Financial Service Subsidiaries

As described above, the Company owns all of the outstanding capital stock of the Insurance Agencies, which consist of First American Insurance Agencies, Inc., a Minnesota corporation (the "Minnesota Insurance Agency"), and First American Insurance Agencies, Inc., a North Dakota corporation (the "North Dakota Insurance Agency"). The Company is authorized to operate the Insurance Agencies under Sections 4(c)(8)(D) and (G) of the Holding Company Act. See "Supervision and Regulation — Regulation of Company." The Insurance Agencies provide insurance agency services to the Subsidiary Banks' communities and offer as their major products crop-hail and property and casualty insurance. The Minnesota Insurance Agency serves the Subsidiary Banks' communities in

Minnesota and Wisconsin, and the North Dakota Insurance Agency serves the Subsidiary Banks' communities located in North Dakota. The Minnesota Insurance Agency resulted from the consolidation in 1987 of fifteen Minnesota and Wisconsin insurance agencies controlled by the Company, and the North Dakota Insurance Agency resulted from the consolidation in 1987 of nine North Dakota insurance agencies controlled by the Company. Historically, the Company's insurance agency operations have not been significant to its operations. In 1988, the gross commissions paid to the Insurance Agencies was approximately $3.9 million.

The Company also owns all of the outstanding capital stock of First American Trust, a state-chartered trust company formed in 1987 to which the trust business of First American Bank of Marshall (then named First American Bank and Trust of Marshall) was transferred. First American Trust now has trust offices in over half of the Minnesota Subsidiary Banks which provide trust and other fiduciary services for individuals, estates, foundations, business corporations, and charitable organizations. The First American National Bank of St. Cloud in St. Cloud, Minnesota, is the only Minnesota Subsidiary Bank with an active trust department that is not part of First American Trust. The Company is in the process of transferring the business of the trust department of The First American National Bank of St. Cloud to First American Trust. First American Bank & Trust of Minot in Minot, North Dakota, has a trust department that provides fiduciary services to customers in North Dakota. The Company's trust operations have not been significant to the Company's operations. In 1988, the combined trust operations produced $2.8 million in fee income and at December 31, 1988 had fiduciary assets of $555 million under management.

The Company owns a controlling portion of the capital stock of Bremer First American Life Insurance Company. Bremer First American Life Insurance Company was incorporated in 1987 under Arizona law and provides domestic life and disability reinsurance. It is engaged in the underwriting and reinsurance of credit life and credit accident and health insurance sold in conjunction with the extension of credit by all of the Subsidiary Banks. Its operations are not significant to the Company's operations.

Bremer Financial provides management and support services to the Company. See "Business — General." First American Information provides data processing services to the Company's Subsidiary Banks. See "Business — Administration of Subsidiary Banks."

The results of operations of the Company's financial service subsidiaries, taken as a whole, do not have a significant impact upon the financial condition or operations of the Company. The Company believes its financial service subsidiaries complement the services provided by the Subsidiary Banks and make the Company a more complete financial service provider.

Competition

The banking business is highly competitive. As the financial service industry expands, the scope of potential competition for the Subsidiary Banks also expands. The Subsidiary Banks compete with other commercial banks and also savings and loan associations and credit unions for loans and deposits and with money market funds for deposits. Consumer and commercial finance companies, department stores, factors, mortgage banks and insurance companies are also important competitors for various types of loans. Some of these entities and institutions are not subject to the same regulatory restrictions as the Company and the Subsidiary Banks. Recent changes in state laws relating to interstate banking may also have an effect on competition. While the Company's management cannot fully predict the impact of these laws, it anticipates that competition may intensify as local institutions become part of larger national organizations. See "Supervision and Regulation — Interstate Banking."

Management believes that each Subsidiary Bank will be able to continue to compete successfully in its community. Management further believes that the Company's emphasis on local autonomy and the ability of the Subsidiary Banks to make decisions close to the marketplace, the Subsidiary Banks' community commitment and involvement, and the commitment to a strong sales culture and to providing quality banking services, are factors that should allow the Subsidiary Banks to continue to maintain and improve their competitive position. The Company's size, combined with Bremer Financial's support services in specialized areas, add to the strength of the individual Subsidiary Banks, enabling them to compete more effectively. The Subsidiary Banks compete by participating loans to other Subsidiary Banks in order to service customers requiring large loans. See "Business — Administration of Subsidiary Banks."

Economic Environment

General

The monetary policies of regulatory authorities, including the Federal Reserve Board, have a significant effect on the operating results of bank holding companies and their subsidiary banks, including the Company and the Subsidiary Banks. The Federal Reserve Board regulates the national supply of bank credit. Among the means available to the Federal Reserve Board to regulate such supply are open market operations in U.S. government securities, changes in the discount rate on depository institution borrowings, and changes in reserve requirements against depository institution deposits. These means are used in varying combinations to influence growth and the distribution of bank loans, investments, and deposits, and their use may affect interest rates charged on loans or paid for deposits.

Effect of Regional Economies

The banking industry is affected by general economic conditions beyond the Company's or the Subsidiary Banks' control, such as inflation, recession, unemployment and other factors. A depressed agricultural economy in recent years caused some severe hardships in the areas in which some of the Subsidiary Banks are located, resulting in increases in their non-performing assets and charge-offs in 1985 and 1986. This depressed agricultural economy not only affected agribusiness but also the "main street businesses" in the Subsidiary Banks' communities. Recent published economic analyses indicate that the agricultural sector of the economy is improving. In addition, improved credit policies initiated by the Subsidiary Banks mitigated the impact of a depressed agricultural economy on the Subsidiary Banks and the Company. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Corporate Risk Profile — Credit Management."

Employees

As of December 31, 1988, the Company and its subsidiaries (including the Subsidiary Banks) had a total of 1,187 full-time equivalent positions. The Company and each of its subsidiaries considers its relations with employees to be good, as evidenced by annually conducted employee opinion surveys.

Properties

The Company and Bremer Financial lease their principal offices at 55 East Fifth Street, Saint Paul, Minnesota, which consist of approximately 12,800 square feet of space. Each of the Subsidiary Banks owns its main offices and its branches; the facilities are all well maintained and range in size from 640 square feet to 55,016 square feet.

Certain properties of the Subsidiary Banks are subject to pledges or mortgages. See Notes F and G to the Consolidated Financial Statements of the Company included elsewhere in this Prospectus.

Trademarks

The Company has registered the "Bremer Eagle" symbol appearing on the cover page of this Prospectus with the United States Patent and Trademark Office. This trademark is used by all Subsidiary Banks. The Company has also registered a stylized version of the word "Transaction" with the United States Patent and Trademark Office for use in connection with the Subsidiary Banks' automatic teller machine cards. The Company has registered no other trademarks, patents or copyrights. While management believes that a trademark or service mark is useful in identifying and advertising a common identity among the Subsidiary Banks and the Company or a service offered by the Subsidiary Banks, it believes that the "Bremer Eagle" symbol, the "Transaction" service mark, or any other trademark, patent, or copyright or the registration thereof is not material to the business of the Company or its subsidiaries.

Litigation

The Company and certain of its Subsidiary Banks are involved in legal actions in various stages of litigation and investigation. After reviewing all actions pending or threatened involving the Company and such Subsidiary Banks, management believes that such legal actions, whether pending or threatened, constitute ordinary routine litigation incidental to the business of the Company and the Subsidiary Banks and that the ultimate resolution of these matters should not materially affect the Company's consolidated financial position or operations. However, many of these matters are in only the preliminary stages, and further developments could cause management to revise its assessment of these matters.

SUPERVISION AND REGULATION

The following discussion of applicable statutes, regulations and policies are brief summaries thereof and do not purport to be complete and are qualified in their entirety by reference to such statutes, regulations and policies.

Regulation of Company

The Company is a multi-state bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "Holding Company Act"), and, as such, is subject to supervision by the Federal Reserve Board. The Company must obtain the approval of the Federal Reserve Board before it acquires all or substantially all of the assets of a bank or another bank holding company, merges or consolidates with another bank holding company, or acquires ownership or control of any voting shares of a bank or a bank holding company if, after such acquisition, it would own or control more than 5% of such voting shares (unless it already owns or controls the majority of such shares). In addition, any direct or indirect acquisition by a bank holding company of more than 5% of the voting shares of, or all or substantially all of the assets of, a bank located in another state may not be approved by the Federal Reserve Board unless the laws of the second state specifically authorize the acquisition. See "Supervision and Regulation — Interstate Banking." The Company must also obtain Federal Reserve Board approval prior to redeeming any of its equity securities in an amount in excess of 10% of its net worth in any twelve-month period. Furthermore, under certain circumstances, any redemptions, dividends or distributions with respect to the Company's equity securities may be considered an unsafe or unsound practice by the Federal Reserve Board.

Before any "company," as defined in the Holding Company Act, may acquire "control," as defined in the Holding Company Act, over the Company, the prior approval of the Federal Reserve Board is required. The term "company" is defined in the Holding Company Act to include any bank, corporation, general or limited partnership, association or similar organization, or business trust or any trust (unless by its terms, the trust must terminate either within twenty-five years or within twenty-one years and ten months after the death of individuals living on the effective date of the trust). The term "control" is defined in the Holding Company Act to include the ownership, control, or power to vote 25% or more of the outstanding shares of any class of voting stock of a bank or other company, directly or indirectly or acting through one or more persons; control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the bank or other company; or the power to exercise, directly or indirectly, a controlling influence over the management or policies of the bank or other company as determined by the Federal Reserve Board. In addition, before any individual or entity which is not required to seek prior approval from the Federal Reserve Board as set forth above may acquire control of the Company, prior notice to the Federal Reserve Board is required pursuant to Section 225.41 of Regulation Y of the Federal Reserve Board. Under Section 225.41 of Regulation Y, the following transactions constitute, or are presumed to constitute, the acquisition of "control" requiring prior notice: (1) the acquisition of any voting securities of a bank holding company if, after the transaction, the acquiring person (or persons acting in concert) owns, controls, or holds with the power to vote 25% or more of any class of voting securities of the institution; or (2) the acquisition of any voting securities of a bank holding company if, after the transaction, the acquiring person (or persons acting in concert) owns, controls, or holds with the power to vote 10% or more (but less than 25%) of any class of voting securities of the institution, and if: (i) the institution has registered securities under Section 12 of the Securities Exchange Act of 1934, or (ii) no other person will own a greater percentage of that class of voting securities immediately after the transaction.

Under the Holding Company Act, the Company is permitted, directly or through subsidiaries, to engage in a variety of financial activities (and to own shares of companies engaged in certain activities) found by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. A bank holding company is normally not permitted, however, to acquire direct or indirect ownership of more than 5% of the voting shares of any company which is not a bank or not engaged in activities determined by the Federal Reserve Board to be closely related to banking. Certain exemptions are available with respect to subsidiaries engaged in servicing and liquidating activities, companies acquired by a bank holding company in satisfaction of debts previously contracted, or companies engaged in certain insurance activities. For example, the business of the Insurance Agencies is exempted under Sections 4(c)(8)(D) and (G) of the Holding Company Act. Another principal exception to this prohibition allows the acquisition, following an application or notice process, of interests in companies whose activities are found by the Federal Reserve Board, by order or regulation, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the activities that have been determined by regulation to be closely related to banking are making or servicing loans, underwriting credit life insurance, performing certain data processing services, acting as an investment or financial advisor, and providing discount securities brokerage services. As an example, the business of Bremer First American Life Insurance Company has been determined by application to the Federal Reserve Board to be closely related to banking. Other activities approved by the Federal Reserve Board include consumer financial counseling, tax planning and tax preparation, futures and options advisory services, check guaranty services, collection agency and credit bureau services, and personal property appraisals. In determining whether a particular activity is a proper incident to banking or managing or controlling banks, the Federal Reserve Board considers whether its performance by an affiliate of the holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, which outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. The Federal Reserve Board is also empowered to differentiate between activities commenced de novo and activities commenced through the acquisition of a going concern.

The Company and the Subsidiary Banks are prohibited from engaging in certain tie-in arrangements in connection with the extension of credit or the lease or sale of any property or the furnishing of services. The Subsidiary Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to, investments in the stock or other securities of, the taking of such stocks or securities as collateral for loans to, or the purchase of assets from or the guarantee of obligations of, the Company or any of its subsidiaries. The provisions of Section 23A of the Federal Reserve Act and related statutes place limits on all insured banks (including all of the Subsidiary Banks) as to the amount of loans or extensions of credit to, or investments in, or certain other transactions with, their parent bank holding company and certain of such holding companies' subsidiaries and as to the amount of advances to third parties collateralized by the securities or obligations of bank holding companies or their subsidiaries. In addition, most of these loans and certain other transactions must be secured in prescribed amounts. As a result of amendments to Section 23A of the Federal Reserve Act and related statutes adopted in 1982, certain exemptions from the foregoing restrictions apply to transactions between 80% or more owned bank subsidiaries of the same bank holding company. The Company owns 80% or more of the stock of each of the Subsidiary Banks.

The International Lending Supervision Act of 1983, among other things, required each federal banking agency to cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital and other appropriate measures. It further provided that such agencies may issue directives to banking institutions that fail to maintain required levels of capital requiring such institutions to submit and adhere to plans to achieve required capital levels. During 1985, the federal banking agencies issued new capital adequacy standards under which bank holding companies and commercial banks are expected to maintain a minimum primary capital to total assets ratio of 5.5% and a minimum total capital to total assets ratio of 6%, coupled with regulations providing that capital directives (having the force of cease and desist orders) may be issued to mandate the maintenance of adequate capital levels. In 1986, the Federal Reserve Board amended its capital adequacy guidelines to permit certain perpetual debt securities to be treated as primary capital and to impose certain limitations on the amount of mandatory convertible instruments, perpetual preferred stock, and perpetual debt that may qualify as primary capital. The Company's capital is in excess of the minimum standards. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Performance Overview — Dividends and Shareholder's Equity." In addition, the Federal Reserve Board has issued a policy statement that discourages bank holding companies experiencing earnings weaknesses, inadequate capital, or other serious problems from paying dividends that are not covered by earnings or are derived from borrowed funds or unusual or nonrecurring gains. Bank holding companies are expected to maintain adequate capital to meet financial obligations as they come due and to serve as a financial resource to their subsidiaries.

In March 1988, the Federal Reserve Board published proposed risk-adjusted capital adequacy guidelines. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Performance Overview — Dividends and Shareholder's Equity." On December 16, 1988, the Federal Reserve Board adopted as final its risk-based capital guidelines. The Federal Reserve Board's guidelines assign risk ratings to various types of assets to take into account the different risks associated with different assets under these guidelines. The risk categories range from a 0% bracket, which includes such low-risk assets as cash and treasury bills, to a 100% bracket, which includes such high-risk assets as commercial loans and standby letters of credit. At September 30, 1988, the Company's risk adjusted capital adequacy ratios were above the minimums set forth in the Federal Reserve Board's guidelines.

The Federal Reserve Board has enforcement powers over bank holding companies and their non-banking subsidiaries to forestall activities that represent unsafe or unsound practices or constitute violations of law. These powers may be exercised through the issuance of cease and desist orders or other actions. The Federal Reserve Board is also empowered to assess civil penalties against companies or individuals who violate the Holding Company Act in amounts of up to $1,000 for each day's violation, to order termination of non-banking activities of non-banking subsidiaries of bank holding companies, and to order termination of ownership and control of non-banking subsidiaries by bank holding companies.

Regulation of Subsidiary Banks

Each of the Subsidiary Banks is either a state or national bank, and accordingly each is subject to extensive regulation. The state Subsidiary Banks incorporated under Minnesota law are subject to regulation by the Minnesota Department of Commerce, the state Subsidiary Banks incorporated under Wisconsin law are subject to regulation by the Wisconsin Commissioner of Banking, and the North Dakota Subsidiary Banks are subject to regulation by the North Dakota Department of Banking and Financial Institutions. In addition, and because the deposits of the Company's state Subsidiary Banks are insured up to the applicable limit (currently $100,000) by the FDIC, all of the state Subsidiary Banks are subject to regulation by the FDIC. As an insurer, the FDIC issues regulations, conducts examinations, and generally supervises the operation of its insured members. This supervision extends to a comprehensive regulatory scheme governing, among other things, capital requirements, lending limits, transactions between affiliates, and the safety and soundness of the Subsidiary Banks' activities in general. In addition, the consent of the FDIC generally would be required for any major corporate reorganization involving any of the state Subsidiary Banks, including a merger or significant purchase or disposition of assets. Any insured institution which does not operate in accordance with or conform to FDIC regulations, policies and directives may be sanctioned for non-compliance. For example, proceedings may be instituted against any insured institution or any director, officer, employee or person participating in the conduct or affairs of such institution who engages in unsafe and unsound practices, which includes a violation of applicable laws and regulations. The FDIC has the authority to terminate the insurance of accounts pursuant to procedures established for that purpose.

Each of the national Subsidiary Banks is organized under the National Bank Act and is subject to regulation by the Comptroller, the FDIC and the Federal Reserve Board. These regulatory authorities issue regulations, enforce applicable statutory laws, conduct examinations and generally supervise the operations of the national Subsidiary Banks. Their supervision also includes a comprehensive regulatory scheme governing, among other things, capital requirements, lending limits, transactions between affiliates, dividends, and the safety and soundness of the national Subsidiary Banks' activities in general. Any national Subsidiary Bank which does not operate in accordance with or conform to these regulations and applicable laws, policies and directives may be sanctioned for non-compliance.

In March 1980, the Depository Institution Deregulation and Monetary Control Act of 1980 was adopted which, among other matters, provided for the phase-out over a six-year period of interest rate ceilings on time deposit accounts applicable to commercial banks and thrift institutions. Effective April 1, 1986, the phase-out was completed, and there are no longer any limitations on the rate of interest that may be paid by such institutions on time deposit accounts, although there is a remaining prohibition on the payment of interest on demand deposit accounts.

A substantial portion of the Company's cash flow and income is derived from dividends paid to it by the Subsidiary Banks. In addition to the statutory prohibition against the withdrawal of any portion of a Subsidiary Bank's capital and certain statutory limitations on the payment of dividends, the approval of the Comptroller is required for the payment of any dividend to the Company by any national Subsidiary Bank if the total of all dividends declared by any such Subsidiary Bank in any calendar year exceeds the total of its net profits (as defined) for that year combined with its retained net profits for the preceding two calendar years, less any required transfer to surplus. The Comptroller also has issued a banking circular emphasizing that the level of cash dividends should bear a direct correlation to the level of a national bank's current and expected earnings stream, the bank's need to maintain an adequate capital base, and other factors. A Minnesota state bank may declare and pay dividends only out of accumulated net earnings, only so long as it complies with certain capital requirements, and only if it obtains the prior approval of the Minnesota Commissioner of Commerce. A Wisconsin state bank may declare and pay dividends only out of cumulative net profits for the last two years, and the prior approval of the Wisconsin Commissioner of Banking is required to pay dividends in excess of such amount. A North Dakota bank may declare and pay dividends out of cumulative adjusted net profits for the last three years, and the prior approval of the North Dakota Department of Banking and Financial Institutions is required for dividends paid that exceed that statutory limit. In addition, the appropriate federal or state banking agency could take the position that it has the power to prohibit a national or state bank from paying dividends if, in its view, such payments would constitute unsafe or unsound banking practices.

The payment of dividends by any bank or bank holding company is affected by the requirement to maintain adequate capital pursuant to the capital adequacy guidelines issued by the Federal Reserve Board and regulations issued by the FDIC and the Comptroller. The FDIC and the Comptroller each have issued capital adequacy regulations for state banks subject to the FDIC's primary supervision and for national banks, respectively, which provide for a minimum ratio of primary capital to total assets of 5.5% and total capital to total assets of 6.0%. These guidelines and regulations further provide that capital adequacy is to be considered on a case-by-case basis in view of various qualitative factors that affect a bank or bank holding company's overall financial condition. For purposes of calculating these ratios, primary capital consists of the sum of common stock and surplus, minority interests in the equity accounts of consolidated subsidiaries, the allowance for loan losses, undivided profits, and, up to certain percentage limits, preferred stock and surplus, perpetual debt, and mandatory convertible instruments; total capital consists of primary capital plus limited life preferred stock and subordinated instruments, as well as all preferred stock and surplus, perpetual debt, and mandatory convertible debt in excess of the percentage that qualifies as primary capital; and total assets include the allowance for loan losses. (For a discussion of the risk-adjusted capital adequacy guidelines adopted as final in December 1988 and March 1989 by the Comptroller and the FDIC, respectively, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Performance Overview — Dividends and Shareholder's Equity.")

The Subsidiary Banks are in compliance with the minimum capital guidelines described above because the Subsidiary Banks have capital ratios above the minimum capital guidelines. At December 31, 1988, the primary capital ratio of the Subsidiary Banks on a combined basis was 9.3%, ranging from a low of 7.3% to high of 13.9%. The above regulations and restrictions on dividends paid by the Subsidiary Banks may limit the Company's ability to obtain funds from such dividends for its cash needs, including funds for payment of operating expenses and dividends on the Class A and Class B Common Stock. However, because of the strong capital positions of the Subsidiary Banks, the Company has been able to obtain dividends sufficient to meet its cash flow needs. For the years ended December 31, 1987 and 1988, the combined dividends paid by the Subsidiary Banks were $9.9 million and $9.7 million, respectively. Four Subsidiary Banks paid no dividends in 1988, and, of the ones that paid dividends, the range of dividend payouts (dividends paid divided by net income) was 11% to 162%. The Company anticipates having sufficient cash flow to meet its obligations to pay dividends on the Class A Common Stock and Class B Common Stock. See "Description of Capital Stock."

On August 10, 1987, the President of the United States signed into law the Competitive Equality Banking Act of 1987 (the "Competitive Equality Act"). The Competitive Equality Act amends the Federal Reserve Act by adding a new Section 23B, which, among other things, prohibits a state FDIC-insured bank, national banks, and their subsidiaries and certain affiliates from engaging in certain transactions (including, for example, loans) with certain affiliates unless the transactions are substantially the same, or at least as favorable to such bank or its subsidiaries, as those prevailing at the time for comparable transactions with or involving other non-affiliated companies. In the absence of such comparable transactions, any transaction between a member bank and its affiliates must be on terms and under circumstances, including credit standards, that in good faith would be offered to or would apply to non-affiliated companies.

During 1986, and in part in recognition of the problems in the agricultural sectors of the economy, the federal bank regulatory agencies adopted supervisory policies designed to assist certain agricultural banks. These measures included the issuance of a new capital forebearance policy (under which certain banks may be permitted to operate below minimum capital standards until January 1, 1993), encouragement of the restructuring of troubled debt, certain changes to regulatory reporting requirements, and substitute lending limits with respect to national banks that have experienced certain agricultural charge-offs. In mid-1987, this capital forebearance policy was modified to extend to all banks and to continue until January 1, 1995. In December 1986, the FDIC issued a revised policy statement setting forth criteria to be applied in considering proposals for it to provide assistance to prevent the closing of an FDIC-insured bank. Two of the Company's Subsidiary Banks are operating under capital forbearance policies, and, as of December 31, 1988, both of these Subsidiary Banks had capital levels above the required minimum set forth in their respective forebearance policy.

Effects of Interest Rates and Usury Laws

State usury laws limit the rate of interest that may be charged by the Subsidiary Banks. Certain federal laws provide a limited preemption of state usury laws. The maximum rate of interest that the Subsidiary Banks may charge on business loans under Minnesota law is unlimited if the loan is made to a corporation, government or governmental subdivision or agency, trust estate, partnership, joint venture, cooperative or association, or if the loan is secured by real estate or is in an amount in excess of $100,000. Under the Uniform Consumer Credit Code as recently adopted in Minnesota, Subsidiary Banks may charge up to 19% per annum on other loans, including business loans of up to $100,000. Alternatively, under the authority of the Most Favored Lender Doctrine, which has recently been extended to FDIC-insured Minnesota state banks by the Minnesota Supreme Court, Minnesota Subsidiary Banks may charge interest of up to 21¾% per annum on all loans which may also be made by

Minnesota industrial loan and thrift institutions. The maximum rate of interest that the Subsidiary Banks may charge on loans under Wisconsin and North Dakota law is unlimited at the present time. State usury ceilings on loans have not affected the Company's operations in recent years but could affect its operations in the future if market interest rates exceed those permissible under Minnesota law or if new interest rate limitations are enacted.

Interstate Banking

The acquisition of shares of capital stock or substantially all of the assets of a bank located outside of the state in which the operations of a bank holding company's banking subsidiaries were principally conducted on July 1, 1966, or the date on which the company became a bank holding company, whichever is later, is restricted by Section 3(d) of the Holding Company Act. Such acquisition is subject to the law of the state in which the bank to be acquired is located. The Federal Reserve Board may not approve any application for such acquisition unless the acquisition of the shares or assets of the bank by the out-of-state bank holding company is specifically authorized by the statutes of the state in which the bank to be acquired is located. For purposes of Section 3(d) of the Holding Company Act, the Company is located in Minnesota. Because the Company had Wisconsin and North Dakota Subsidiary Banks on July 1, 1966, these interstate banking activities in North Dakota and Wisconsin existing on July 1, 1966 are "grandfathered in" under Section 3(d) of the Holding Company Act. Therefore, the Company was not required by Section 3(d) of the Holding Company Act to divest its North Dakota or Wisconsin Subsidiary Banks. However, the Company is not permitted to acquire an interest in any other bank located outside Minnesota in circumstances that require Federal Reserve Board approval, unless permitted by state law. Further, any company attempting to acquire control of the Company or any of its Subsidiary Banks may also be subject to these limitations on interstate banking.

The status of interstate banking legislation adopted by the individual states has been in a constant state of change in recent years. While a number of states have adopted some form of legislation which allows interstate banking by bank holding companies, significant limitations still apply. For example, states in various regions of the United States (including, with certain qualifications, Minnesota and Wisconsin) have enacted statutes permitting acquisitions of local banks by out-of-state bank holding companies if: (1) the out-of-state bank holding company's home state permits local bank holding companies to acquire banks located in the out-of-state bank holding company state; and (2) the out-of-state bank holding company is located within a defined region. Minnesota and Wisconsin are two states which have adopted such reciprocal banking laws. Minnesota's interstate legislation allows banks or bank holding companies located in Minnesota to be acquired by Iowa, North Dakota, South Dakota, Wisconsin, Colorado, Idaho, Illinois, Kansas, Missouri, Montana, Nebraska, Washington, or Wyoming bank holding companies so long as there is reciprocating legislation in those states allowing Minnesota bank holding companies to acquire control of banks located in that particular state. Wisconsin has similar reciprocal interstate banking laws with Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri and Ohio. In addition to the foregoing reciprocal legislation, the Company successfully obtained special legislation in North Dakota, Wisconsin and Minnesota which would allow the Company, subject to the various conditions and limitations set forth in the special legislation, to be acquired by a bank holding company or any other entity located in any state. After the consummation of the sale of the Class A Common Stock by the Foundation pursuant to this offering, there may be a question as to the continued availability of the North Dakota, Wisconsin or Minnesota special legislation to the Company or the Foundation in connection with the acquisition of the Company by a potential purchaser. Any company attempting to acquire the Company would therefore have to determine the availability of the Minnesota, North Dakota or Wisconsin special legislation and any other permissive interstate legislation enacted by the appropriate states before the acquisition of the Company could be consummated.

Deregulation

There have been significant changes in the banking industry in recent years. Many of these changes have been effected by federal legislation intended to deregulate the banking industry. This legislation has, among other things, eliminated interest rate restrictions on time deposit accounts and increased the power of nonbanks to expand into traditional banking services.

Future changes in the banking industry may include some modification of prohibitions on the types of businesses in which bank holding companies may engage. In addition, other types of financial institutions, including mutual funds, securities brokerage companies, insurance companies, and investment banking firms, have been given, and may continue to be given, powers to engage in activities which generally have been engaged in only by banks. Such changes may place the Company and the Subsidiary Banks in more direct competition with these other financial institutions. See "Business — Competition."

Limitations on Acquisitions

The Plan of Reorganization contains certain provisions which may have the effect of making it more difficult to acquire voting control of the Company, and the Company may be subject to laws which have such effect. Although management of the Company and the Foundation is not aware of any effort that might be made to obtain control of the Company, the Board of Directors of the Company and the Trustees of the Foundation believe that it was and is in the best interests of the Company and its shareholders to adopt these provisions to protect against a hostile or unfriendly takeover. Management believes that these provisions benefit shareholders by enabling management to make decisions believed to be in the long-term best interests of all shareholders.

As described in the portion of this Prospectus entitled "Description of Capital Stock," under the Plan of Reorganization the Company or its assignee would have an option to purchase shares of Class A Common Stock proposed to be disposed of or transferred to a third party or entity. If the Company or its assignee exercised its option, the holder proposing the transfer or other disposition would be required to sell his or her shares to the Company or its assignee. Therefore, no person or entity may acquire shares of Class A Common Stock from any person other than the Foundation without the Company or its assignee first having an opportunity to purchase such shares.

After the completion of this offering, the Company may be subject to the Minnesota Control Share Acquisition Act ("CSAA") and the Minnesota Business Combination Statute ("BCS"). The CSAA prohibits in certain circumstances a person acquiring beneficial ownership of at least 20% of the voting shares of a Minnesota publicly-held company from voting such shares without the approval of the Company's shareholders. The BCS prohibits for a five-year period certain business combination transactions between a company acquiring shares of a publicly-held company and the publicly-held company without the approval of the shareholders of the publicly-held company. In addition, after this offering, any tender offer to acquire the Company's Class A Common Stock, any proxy contest with respect to the election of directors, or any other matters submitted to a vote of holders of Class A Common Stock may be subject to the limitations and disclosure requirements of Minnesota Statutes, Chapter 80B, and the federal Securities Exchange Act of 1934.

Any "change in control" of the Company would be subject to the prior approval of the applicable bank regulatory authorities, including the Federal Reserve System under the Holding Company Act and Regulation Y of the Federal Reserve Board. See "Supervision and Regulation — Regulation of Company." The prior approval of the Federal Reserve Board is required before any "company" may acquire "control" over the Company (as defined in the Holding Company Act). In addition, before any individual or entity which is not required to seek prior approval from the Federal Reserve Board may acquire control of the Company, prior notice to the Federal Reserve Board is required pursuant to Regulation Y of the Federal Reserve Board. Under Regulation Y, a "change in control" includes the acquisition of voting securities which would cause the acquiring person to own, control, or hold, after such acquisition, 10% or more (but less than 25%) of any class of voting securities of a bank holding company (i) if the bank holding company has registered securities under the Securities Exchange Act of

1934 (the "1934 Act"), or (ii) no other person will own a greater percentage of that class of voting securities immediately after the transaction. It is anticipated that the Company may first have a class of stock registered under the 1934 Act in 1990. In addition, if the acquiring person is a corporation, it may be required under the Holding Company Act to file an application with the Federal Reserve Board to obtain its prior approval of such an acquisition.

The acquisition of the Company, as a multi-state bank holding company, is restricted by Section 3(d) of the Holding Company Act. Any companies seeking to acquire control of the Company would need to have available permissive interstate banking legislation of the type described in "Supervision and Regulation — Interstate Banking" before any control acquisition could be consummated.

The foregoing provisions and limitations would make it difficult for companies, other entities, or individuals to acquire control of the voting power of the Company in a hostile or unfriendly takeover and could result in the deterrence of offers to the holders of Class A Common Stock which might be viewed by such shareholders to be in their best interests.

Restrictions Imposed on ESOP and Profit Sharing Plan by Federal Reserve Board

In June 1988, the Company and the Foundation filed a request for opinion with the Federal Reserve Board to obtain its opinion that, among other things, neither the ESOP nor the Profit Sharing Plan would be a "bank holding company" within the meaning of the Holding Company Act as a result of the ESOP's purchase of shares of Class A Common Stock and the use of vested account balances in the Profit Sharing Plan to purchase shares of Class A Common Stock. In February 1989, the Federal Reserve Board responded and stated that neither the ESOP nor the Profit Sharing Plan would be considered a "bank holding company" within the meaning of the Holding Company Act if the Company and the Foundation, and the ESOP and/or the Profit Sharing Plan, made the following commitments, which have been made by such entities: (1) the ESOP will not, without the prior written approval of the Federal Reserve Board, acquire 25% or more of any class of voting securities, or otherwise acquire control, of any bank or bank holding company; (2) prior to acquiring any non-voting equity interest in any bank or bank holding company, the ESOP must notify the Federal Reserve Bank of Minneapolis of the terms of any such investment; (3) the ESOP will not make any investments that could not be made by a bank holding company under the Holding Company Act, and the ESOP will notify the Federal Reserve Bank of Minneapolis prior to acquiring more than 5% of the voting securities of any "company" (as that term is defined in Regulation Y of the Federal Reserve Board) other than the Company; (4) the ESOP will not acquire, without the prior written approval of the Federal Reserve Bank of Minneapolis, securities of any company, including the Company, if, at the time of such acquisition, the ratio of the combined debt of the Company and the ESOP to the equity of the Company would exceed 30%; (5) the ESOP will not incur any debt without the prior written approval of the Federal Reserve Bank of Minneapolis if, after the ESOP incurs such debt, the ratio of the combined debt of the ESOP and the Company to the equity of the Company exceeds 30%, provided, however, the ESOP may incur short-term debt solely for the purpose of terminating an employee's interests in the ESOP if such debt is not outstanding for a period of more than 180 days; (6) the Profit Sharing Plan and the ESOP will not make any investments that could not be made by a bank holding company under the Holding Company Act or acquire, in the aggregate and when taken together with all investments of the Foundation and the Company, more than 5% of the voting securities of any "company" (as that term is defined in Regulation Y of the Federal Reserve Board), including a bank, other than the Company, without the prior approval of the Federal Reserve Board or the Federal Reserve Bank of Minneapolis; and (7) neither the Profit Sharing Plan nor the Profit Sharing Plan Trust Agreement will be amended to authorize the trustee of the Profit Sharing Plan to purchase, sell, or vote shares of Class A Common Stock except at the express direction of the participant for which such shares are purchased, sold, or voted (or, if the participant is deceased, his or her estate) without the prior approval of the Federal Reserve Bank of Minneapolis.

FEDERAL AND STATE TAXATION

Federal Taxation

Banks and bank holding companies, like other corporations, are subject to federal and state income taxes. Generally, a bank's income tax liability is determined under provisions of the Code applicable to all taxpayers or corporations. However, Sections 581 through 597 apply specifically to financial institutions.

The two primary areas in which the treatment of financial institutions differs from the treatment of other corporations under the Code are the areas of bond gains and losses and bad debt deductions. Bond gains and losses generated from the sale or exchange of portfolio instruments are treated for financial institutions as ordinary gains and losses as opposed to capital gains and losses for other corporations, as the Code considers bond portfolios held by banks to be inventory in a trade or business rather than capital assets. Banks are allowed a statutory method for calculating a reserve for bad debt deductions. This is in addition to methods available to other taxpayers. However, due to the Company's asset size, the Subsidiary Banks cannot use the reserve method for calculating bad debt expense. Consequently, the Company uses the specific charge-off method for calculating bad debt expense. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Income Statement Analysis — Income Taxes." Also, banks are allowed a ten-year carryback of losses generated by bad debts through 1994.

The Company files a consolidated return with its subsidiaries. Consequently, no tax is payable on intercompany dividends received by the Company from the Subsidiary Banks.

State Taxation

The Company files state income tax returns in Minnesota, North Dakota, and Wisconsin. Generally, each state's taxable income is calculated under applicable Code sections with some modifications required by state law. Major state adjustments include net municipal interest income, state tax expense, and depreciation expense. These adjustments are usually added to federal taxable income to determine state taxable income.

The Company files a unitary tax return in Minnesota. The consolidated combined income of the Company and its subsidiaries is then allocated to Minnesota based on statutory apportionment percentages. North Dakota and Wisconsin tax returns are filed on a separate entity basis. Each corporation allocates its own income and expenses based on the amount of business in that state.

Minnesota, Wisconsin, and North Dakota tax banks under primarily the same rules as other corporations. Minnesota does change the apportionment rules for banks to account for intangible assets and interest income. North Dakota denies loss carryforwards and carrybacks for financial institutions. North Dakota also taxes banks at a flat 7% rate versus the corporate graduated rate.

PLAN OF REORGANIZATION

The Foundation is a private foundation described in Section 509(a) of the Code which was formed by Mr. Otto Bremer under a trust agreement dated May 22, 1944. The Foundation owns and at all times since February 15, 1951 has owned all of the issued and outstanding capital stock of the Company. See "The Company and the Foundation." The Foundation's holdings in the Company are subject to the private foundation excise taxes under Chapter 42 of the Code, including the tax on "excess business holdings" imposed by Section 4943 of the Code, which was enacted by the Tax Reform Act of 1969. Generally, Section 4943 of the Code requires private foundations to reduce their holdings in business enterprises over a three-phase divestiture period. The length of the divestiture period varies depending upon the percentage ownership in the business enterprise. Section 4943 operates to tax any excess holdings that are not divested within the required time period. Under Section 4943, the permitted holdings of a private foundation in a business enterprise are generally 20% of the voting stock reduced by the percentage of voting stock owned by certain disqualified persons with respect to the foundation.

Disqualified persons are generally individuals or entities which are closely affiliated with the private foundation. No disqualified persons with respect to the Foundation own any shares of Class A Common Stock or Class B Common Stock, and the Plan of Reorganization provides that no disqualified person may purchase any shares of Class A Common Stock. In cases where the private foundation owns 20% or less of the voting stock of the business enterprise, all nonvoting stock owned by the private foundation will be treated as permitted holdings under Section 4943.

Because the Foundation held 100% of the voting stock of the Company on May 26, 1969, the rules under Section 4943 require the Foundation to divest itself of at least 50% of the voting stock of the Company by May 26, 1989. However, unless the Foundation reduced its percentage ownership of the Company's voting stock to 20% or less, the Foundation would not be entitled to own any of the nonvoting Class B Common Stock. Accordingly, in order to permit the Foundation to retain a greater share of ownership in the Company, management of the Company and the trustees of the Foundation have determined that the most appropriate means of satisfying the divestiture requirements of Section 4943 of the Code is pursuant to the transactions contemplated by the Plan of Reorganization. Under the Plan of Reorganization, and upon the divestiture of 960,000 shares of Class A Common Stock by the Foundation, the Foundation will own 20% of the voting stock of the Company and, in such case, its ownership of all of the nonvoting Class B Common Stock will be treated as permitted holdings for purposes of Section 4943 of the Code.

In order to insure that the transactions contemplated by the Plan of Reorganization would satisfy the divestiture requirements of Section 4943 of the Code, the Foundation and its counsel submitted a private letter ruling request to the Internal Revenue Service (the "IRS") on March 15, 1988. In response to such request, the IRS ruled that the divestiture by the Foundation of 960,000 shares of Class A Common Stock, and the ownership of the remaining 240,000 shares of Class A Common Stock and all of the outstanding Class B Common Stock by the Foundation, as contemplated by the Plan of Reorganization, would satisfy the divestiture requirements under Section 4943 of the Code and would not result in an imposition of a tax on the Foundation for excess business holdings. The Foundation is proceeding with this offering based upon the response received from the IRS pursuant to the private letter ruling request. However, and although the IRS has approved the Plan of Reorganization under the provisions and regulations of and under the Code, including Section 4943 of the Code, such approval does not constitute a recommendation or endorsement of the Plan of Reorganization or this offering.

The Company adopted the Plan of Reorganization on February 8, 1989, and the Company's Articles of Incorporation were then amended pursuant to the Plan of Reorganization to authorize 12,000,000 shares of Class A Common Stock and 10,800,000 shares of Class B Common Stock. Effective February 8, 1989, the Foundation received in exchange for its 7,273 shares of voting common stock of the Company (which then represented 100% of the issued and outstanding capital stock of the Company) 1,200,000 shares of Class A Common Stock and 10,800,000 shares of Class B Common Stock. The Class A Common Stock and the Class B Common Stock are described in the portion of this Prospectus entitled "Description of Capital Stock."

The Foundation is now offering for sale 960,000 shares of the Class A Common Stock acquired by it from the Company, representing 80% of the total number of shares of Class A Common Stock outstanding and 8% of the total number of shares of both Class A Common Stock and Class B Common Stock outstanding. The shares are being offered for sale to the following individuals, groups and entities: (i) directly to employees and directors of the Company, the Subsidiary Banks, and the Company's financial service subsidiaries; (ii) to the ESOP; and (iii) to employees of the Company, the Subsidiary Banks, and the Company's financial service subsidiaries through the Profit Sharing Plan. The Plan of Reorganization provides that no share of Class A Common Stock may be sold to a "disqualified person," as that term is defined in Section 4946(a) of the Code. The offer and sale of the Class A Common Stock by the Foundation is described in the portion of this Prospectus entitled "Plan of Distribution."

After completion of this offering, the Foundation will own approximately 92% of the capital stock of the Company and will have 20% of the voting power with respect to the election of members of the Company's Board of Directors and all other matters properly before the shareholders of the Company (other than Extraordinary Transactions). The Foundation will have approximately 92% of the voting power with respect to a vote relative to an Extraordinary Transaction. See "Special Considerations — Special Considerations Regarding an Investment in the Company — Voting Control of Company."

MANAGEMENT

The executive officers and directors of the Company and certain of its affiliates are as follows:

Name	Age	Positions With the Company and Certain Affiliates
Robert J. Reardon	60	Chairman of the Board of Directors of the Company
Terry M. Cummings	48	President, Chief Executive Officer, and Director of the Company; President, Chief Executive Officer, and Secretary of Bremer Financial Services, Inc.
William H. Lipschultz	58	Vice President, Treasurer and Director of the Company
Gordon Shepard	74	Secretary and Director of the Company
Duaine C. Espegard	45	Vice President of the Company; Region President and Director of Bremer Financial Services, Inc.; President and Chief Executive Officer of First American Bank & Trust of Minot
Kenneth P. Nelson	49	Vice President of the Company; Region President and Director of Bremer Financial Services, Inc.
A.D. Didier	64	Director of Bremer Financial Services, Inc. and President of First American National Bank of St. Cloud
Gene H. Sipe	51	Vice President of the Company; Region President and Director of Bremer Financial Services, Inc.
William B. Naryka	41	Chief Financial Officer of the Company; Senior Vice President, Chief Financial Officer, and Director of Bremer Financial Services, Inc.

Name	Age	Positions With the Company and Certain Affiliates
Robert J. Hall	53	President and Chief Executive Officer of First American Information Services, Inc.
Charles D. Hendrickson	42	President and Chief Executive Officer of First American Insurance Agencies, Inc. (Minnesota and North Dakota)
Lyle C. Sorum	55	Senior Vice President and Director of Marketing of Bremer Financial Services, Inc.

Robert J. Reardon has been Chairman of the Board of Directors of the Company since July 1988 and a Director of the Company since 1961. He was President and Chief Executive Officer of the Company from 1967 until his retirement in July 1988. Mr. Reardon also served as Chairman of the Board of Directors of Bremer Financial Services, Inc. from 1973 until his retirement. He has been a Trustee of the Foundation since 1968.

Mr. Terry M. Cummings has been President, Chief Executive Officer and a Director of the Company since July 1988. Mr. Cummings is also President, Chief Executive Officer, Secretary and a Director of Bremer Financial Services, Inc. and has served in such capacities since 1982.

Mr. William H. Lipschultz has been a Vice President, Treasurer and a Director of the Company since 1961 and a Trustee of the Foundation since 1961. He has also been a Vice President of Stone Container Corp. since 1976; Stone Container Corp. manufactures corrugated cartons and shipping containers and manufactures and prints polyethylene film and bags.

Mr. Gordon Shepard has been the Secretary and a Director of the Company and a Trustee of the Foundation since 1965. Mr. Shepard is a retired partner with the Twin Cities, Minnesota law firm of Oppenheimer, Wolff & Donnelly.

Mr. Duaine C. Espegard has been a Vice President of the Company since January 1989 and a Director and Region President of Bremer Financial Services, Inc. since 1984. He is also President and Chief Executive Officer of First American Bank & Trust of Minot in Minot, North Dakota, and has served in such capacities since 1987. Mr. Espegard also served as President and Chief Executive Officer of First American Bank of Amery in Amery, Wisconsin, from 1977 to 1987.

Mr. Kenneth P. Nelson has been a Vice President of the Company since January 1989 and a Director and Region President of Bremer Financial Services, Inc. since 1984. From 1977 until July 1988, he was President and Chief Executive Officer of Drovers First American Bank of South St. Paul in South St. Paul, Minnesota.

Mr. A.D. Didier has been a Director of Bremer Financial Services, Inc. since 1984. From 1984 until August 1988, he was a Region President of Bremer Financial Services, Inc. He is also President and Chief Executive Officer of First American National Bank of St. Cloud in St. Cloud, Minnesota, and has served in such capacities since 1971.

Mr. Gene H. Sipe has been a Vice President of the Company since January 1989 and a Region President and Director of Bremer Financial Services, Inc. since 1984. From 1971 until July 1988, he was President and Chief Executive Officer of First American National Bank of Crookston in Crookston, Minnesota.

Mr. William B. Naryka has been Chief Financial Officer of the Company since January 1989. In addition, he is Chief Financial Officer, Senior Vice President, and a Director of Bremer Financial Services, Inc. and has served in such capacities since 1983, 1984, and 1987, respectively. From 1982 until 1984, he was Vice President and Controller of Bremer Financial Services, Inc.

Mr. Robert J. Hall has been President and Chief Executive Officer of First American Information Services, Inc. since 1986. He served as Vice President - Chief Administrative Officer of Bremer Financial Services, Inc. from 1983 until 1986 and Vice President - Operations of Bremer Financial Services, Inc. from 1982 until 1983.

Mr. Charles D. Hendrickson has been President and Chief Executive Officer of both the Minnesota and North Dakota First American Insurance Agencies, Inc. since 1987. He was President - Insurance of Bremer Financial Services, Inc. from 1985 until 1987. From 1983 to 1985, Mr. Hendrickson was a Regional Vice President with FBS Insurance, which consists of property/casualty insurance agencies.

Mr. Lyle C. Sorum has been Senior Vice President and Director of Marketing of Bremer Financial Services, Inc. since July 1988. He was Vice President and Director of Marketing for Bremer Financial Services, Inc. from 1984 until 1988.

All directors of the Company hold office until the next annual meeting and until their successors are duly elected and qualified or until their earlier death, resignation or removal from office. The officers of the Company are appointed annually by the Board of Directors and hold office until their successors are chosen and qualified or until their earlier death, resignation or removal from office.

Compensation of Officers and Directors

The following table sets forth information concerning aggregate cash compensation paid by the Company and its subsidiaries for services rendered in all capacities during the fiscal year ended December 31, 1988 to each of the five most highly compensated executive officers whose total compensation paid in cash or cash equivalents exceeded $60,000 and to all executive officers as a group:

Name of Individual or Number in Group	Capacities in Which Served	Cash Compensation*
Robert J. Reardon	Chairman of the Board of Directors, President and Chief Executive Officer of the Company until July 1, 1988	$ 269,600
Terry M. Cummings	President and Chief Executive Officer of the Company since July 1, 1988. Prior to July 1, 1988, President and Chief Executive Officer of Bremer Financial Services, Inc.	$ 191,500
Gene H. Sipe	Region President of Bremer Financial Services, Inc. and, until August 1, 1988, President of First American National Bank of Crookston	$ 150,000
Kenneth P. Nelson	Region President of Bremer Financial Services, Inc. and, until August 1, 1988, President of Drovers First American Bank of South St. Paul	$ 145,000

Name of Individual or Number in Group	Capacities in Which Served	Cash Compensation*
A.D. Didier	President and Chief Executive Officer of First American National Bank of St. Cloud since 1971. Prior to August 1, 1988, Region President of Bremer Financial Services, Inc.	$ 107,100
All executive officers as a group (12 persons)		$1,421,400

*Cash compensation consists of salary payments for the year ended December 31, 1988; payments accrued in 1987 but paid in 1988 under the Company's Annual Incentive Compensation Plan as follows: Mr. Cummings ($31,500), Mr. Sipe ($18,500), Mr. Nelson ($17,000), Mr. Didier ($2,100), and all executive officers as a group ($83,300); and a $9,600 trustee fee paid by the Foundation to Mr. Reardon.

Compensation Pursuant to Plans

Annual Incentive Compensation Plan

The Board of Directors of the Company has established an annual cash incentive compensation plan (the "Incentive Plan"), which was designed to provide, through cash awards, an incentive to key officers of the Company and its subsidiaries to meet or exceed prescribed targets, consisting of both individual goals and earnings objectives of the Company and/or its subsidiaries. The Incentive Plan for the year ended December 31, 1988 specified a maximum award ranging from 10% to 40% of salary depending upon the officer's position and level of responsibility. Lesser amounts may be paid based on the degree of attainment of the goals. The awards are paid in cash and approved by the Board of Directors and the President and Chief Executive Officer of the Company. Total aggregate payments made under the Incentive Plan in 1988 which were earned in 1987 and which are included in the Cash Compensation Table above for all eligible participants (including the executive officers shown in the Cash Compensation Table above) were $141,100.

Employee Stock Ownership Plan

Since January 1, 1989, the Company has maintained the Bremer Financial Corporation Employee Stock Ownership Plan (the "ESOP") for all employees of the Company and its affiliates. The ESOP is a discretionary defined contribution plan designed to invest primarily in the capital stock of the Company, including the Class A Common Stock. Prior to any sale of shares of Class A Common Stock to the ESOP, Piper, Jaffray & Hopwood Incorporated will render a fairness opinion to the ESOP with respect to the shares being sold it. All employees who have completed one year of service with the Company and/or any of its affiliates (including the Subsidiary Banks) and have attained age 21 may participate in the ESOP if they were receiving current compensation from the Company (or any of its subsidiaries) on December 31, 1988. Thereafter, all eligible employees are entitled to participate in the ESOP after completing one year of service with the Company or any of its affiliates and having attained age 21. The participants' non-forfeitable interest in their ESOP account is based on each employee's years of service. After two years of service, the employee is 25% vested; after three years of service, the employee is 50% vested; after four years of service, the employee is 75% vested; and after five years of service, the employee is 100% vested. The ESOP will be funded solely with contributions made by the Company. The Board of Directors of the Company has sole and exclusive discretion as to the amounts contributable, whether or not any amounts will be contributed, and whether such amounts will be contributed in the form of cash or employer securities. There are no performance formulas or measures included in making such determination. It is the intention of the Company to make annual contributions to the ESOP equal to the "discretionary" component of the Profit Sharing Plan. See "Management — Compensation Pursuant to Plans — Profit Sharing Plan." To the extent contributions are necessary to service any debt of the ESOP, the Company will make the necessary contributions. The maximum amount contributable under the ESOP (assuming it has not borrowed any funds to purchase the

Company's capital stock) is 15% of the covered compensation of all eligible employees, reduced by any amounts contributed to the Company's Profit Sharing Plan (which is discussed below). The maximum amount contributable under the ESOP (assuming it has borrowed funds to purchase the Company's capital stock) is 25% of the covered compensation of all eligible employees (to repay principal), plus amounts necessary to repay interest, reduced by any amounts contributed to the Company's Profit Sharing Plan and reduced by amounts contributed to the Company's Pension Plan (which is discussed below). "Covered compensation" includes all regular salary and wages paid or accrued for eligible employees and 75% of the prior year's "qualified commissions" (which is defined as commissions received as part of a specified compensation plan as approved by the Plan Administrator), but excludes overtime and bonuses. Amounts may be contributed for eligible employees for each year in which a contribution is made to the ESOP from the time the employee becomes eligible to participate until the time the employee no longer participates. Benefits will be distributed to employees or their beneficiaries in the event of an employee's retirement, death or disability. In addition, an employee who terminates his or her employment with the Company or any of its related entities will receive a distribution beginning not later than one year after the fifth year following the year in which the employee leaves the ESOP and then over a period of not longer than five years. The ESOP was adopted on November 4, 1988, and there have been no material amendments to the ESOP since that time. There have been no distributions under the ESOP to any individuals, including the officers and the group of officers identified in the Cash Compensation Table above, and there have been no amounts accrued under the ESOP for any of the officers or the group of officers identified in such Cash Compensation Table. The Trustee of the ESOP is American National Bank and Trust Company, which is not an affiliate of the Company, and the Administrator is the Company.

Unless and until the Class A Common Stock becomes "registration-type class of securities" pursuant to Section 409(e)(4) of the Code, the Trustee(s) of the ESOP will vote all unallocated shares with respect to all matters voted on by holders of the Class A Common Stock and all allocated shares, except for those "major corporate" transactions set forth in Section 409(e)(3) of the Code (which include the approval or disapproval of any corporate merger or consolidation, recapitalization, reclassification, liquidation, or dissolution; the sale of substantially all assets of a trade or business; or similar transactions prescribed by regulation). In the event of any such "major corporate" transaction, or if the Class A Common Stock becomes "registration-type class of securities," each participant would be entitled to vote the shares of Class A Common Stock allocated to his or her account on a one vote per share basis. It is anticipated that the Class A Common Stock will be registered under the Securities Exchange Act of 1934 in 1990, thereby becoming a "registration-type class of securities" pursuant to the Code which can be voted by the participant to whose account the shares of Class A Common Stock in the ESOP are allocated.

Under the ESOP, and at the option of the Administrator, cash dividends declared on the shares of Class A Common Stock held by the ESOP will be used to repay an exempt loan, distributed to the ESOP participants, or allocated to the participants' other investments account. To the extent that cash dividends declared on the Class A Common Stock held by the ESOP are distributed to the participants (whether directly or indirectly) or used to repay an exempt loan, the dividends will be deductible to the Company. Any dividends paid in the form of Class A Common Stock with respect to shares allocated to the individual participants' accounts will be allocated to such accounts, and dividends paid in the form of Class A Common Stock with respect to shares held in the suspense account will be added to the suspense account.

Profit Sharing Plan

The Company also maintains under Sections 401(a) and 401(k) of the Code a profit sharing plan known as the Bremer Banks Profit Sharing Plus Plan (the "Profit Sharing Plan") in which executive officers participate on the same basis with all other employees, subject to certain overall and specific anti-discrimination restrictions. The Profit Sharing Plan was originally adopted effective January 1, 1967 and has most recently been restated effective January 1, 1986. It is a defined contribution profit sharing plan designed to provide retirement benefits to the employees of the Company and its affiliates.

All employees of the Company and its affiliates are eligible to participate in the Profit Sharing Plan after completing one year of service and attaining age 21. The participants' non-forfeitable interest in the Company's contribution to the Profit Sharing Plan is based on each employee's number of years of service. After two years of service, the employee is 25% vested; after three years of service, the employee is 50% vested; after four years of service, the employee is 75% vested; and after five years of service, the employee is 100% vested. Employees are always 100% vested in amounts they contribute on either a pre-tax or after-tax basis (as described below). The Profit Sharing Plan is designed to be funded with both Company contributions and employee contributions. The Company's contribution consists of three components — 2% Credit, Match and Discretionary. Eligible employees are given 2% of their pay as a credit which they can redeposit in the Profit Sharing Plan, which constitutes part of the Section 401(k) portion of the Profit Sharing Plan. The employees are able to contribute to the Profit Sharing Plan on a pre-tax basis up to an additional 13% of their "covered compensation" (which is also part of the Section 401(k) portion of the Profit Sharing Plan). "Covered compensation" includes all regular salary and wages paid to or accrued for employees and 75% of the prior year's "qualified commissions" (consisting of commissions received as part of a specified compensation plan as approved by the Plan Administrator), but excludes overtime and bonuses. The maximum amount an employee may contribute to the Profit Sharing Plan on a pre-tax basis is $7,313 for 1988. The Company will "match" a portion of the employee's pre-tax contributions up to 5% of the employee's covered compensation. The Company's matching contribution equals a maximum of 2.5% of the employee's covered compensation. The Company's matching contributions cannot exceed 50% of the adjusted net earnings of the Company for the particular plan year. The last component, the discretionary part, has been based upon current year profits or earnings of the Company and its subsidiaries, using a formula. Effective January 1, 1989, the calculation and the form of payment of the discretionary component changed. The formula for the discretionary component is based on consolidated earnings of the Company and not individual subsidiary profits; further, it will be paid in the form of the Company's stock contributions (or contributions of cash used to purchase Company capital stock or to repay a loan used to acquire Company capital stock) to the ESOP. See "Management — Compensation Pursuant to Plans — Employee Stock Ownership Plan." Contributions to the Profit Sharing Plan may be made on behalf of all eligible participants from the time they become eligible to participate in the Profit Sharing Plan until they are no longer employed by the Company or any of its subsidiaries. Benefits will be distributed to eligible employees or their beneficiaries in the event of the employee's retirement, death or disability. In addition, a terminated participant will receive a distribution after an appropriate break of service. The Profit Sharing Plan was amended in 1988 to allow investments in employer securities at the sole and exclusive direction of the employees. The Trustee of the Profit Sharing Plan is The First American National Bank of St. Cloud, and the Administrator is Bremer Financial.

No amounts were paid or distributed pursuant to the Profit Sharing Plan to the named individuals and the group identified in the above Cash Compensation Table during 1988. Amounts accrued pursuant to the Profit Sharing Plan for the accounts of the named individuals and group identified in the Cash Compensation Table during 1988, the distribution or unconditional vesting of which are not subject to future events, are as follows: Mr. Terry M. Cummings — $10,960; Mr. Gene H. Sipe — $10,100; Mr. Kenneth P. Nelson — $10,144; Mr. A.D. Didier — $6,303; and all executive officers as a group (twelve persons) — $63,769. Employer contributions for all the Company's employees (including executive officers) participating in the Profit Sharing Plan in 1988 were $1,359,000.

Shares of Class A Common Stock will be voted by the Trustee of the Profit Sharing Plan only if and as directed (in writing) by the participant to whom the shares are allocated. If a participant does not direct the Trustee as to the manner in which the shares in his or her account are to be voted, the shares will not be voted.

Under the Profit Sharing Plan, all cash dividends paid on the Class A Common Stock will be allocated to the accounts of the participants holding shares of Class A Common Stock in their profit sharing accounts. Thereafter, all such proceeds will be available to the participants for investment under the Profit Sharing Plan in accordance with the terms and conditions of the Profit Sharing Plan.

All dividends paid in the form of Class A Common Stock will be allocated to the account of the participant in which the shares are held. In no event will dividends paid on the Class A Common Stock held by the participants' accounts within the Profit Sharing Plan be forfeited or otherwise allocated and held by the trustees of the Profit Sharing Plan.

Pension Plan

The Company maintains a defined benefit pension plan known as the Bremer Banks 1985 Retirement Plan (the "Pension Plan"). The Pension Plan was originally effective April 1, 1985 and is a defined benefit pension plan designed to provide retirement benefits to the employees of the Company and its subsidiaries. All employees of the Company and its subsidiaries are eligible to participate in the Pension Plan after completing one year of service and attaining age 21. Prior to January 1, 1989, an employee's interest in the Pension Plan became non-forfeitable after completing ten or more years of service. Effective January 1, 1989, the Pension Plan was amended to provide full vesting after five or more years of service. The Pension Plan is funded entirely with corporate contributions. The Company's contributions are actuarially determined based upon the age, compensation, and years of service of the participating employees. The criteria used to determine the amounts contributed or payable does not depend upon any performance formula or measure. The maximum time period over which the measurement of benefits will be determined is 35 years.

The following table illustrates estimated annual retirement benefits at age 65 (normal retirement age), excluding Social Security benefits, calculated on assumptions regarding final average compensation (salaries are assumed to remain constant), years of service under the Pension Plan, and 1988 Social Security benefits which would be payable to an employee under the Company's Pension Plan:

	Estimated Annual Retirement Benefits Years of Service			
Compensation	**10**	**20**	**30**	**40**
$ 75,000	$11,250	$22,500	$33,750	$ 39,375
100,000	15,000	30,000	45,000	52,500
125,000	18,750	37,500	56,250	65,625
150,000	22,500	45,000	67,500	78,750
175,000	26,250	52,500	78,750	91,875
200,000	30,000	60,000	90,000	105,000

With respect to the individuals named in the Cash Compensation Table above, the years of covered service are as follows: Mr. Terry M. Cummings (12), Mr. Gene H. Sipe (26), Mr. Kenneth P. Nelson (15), and Mr. A.D. Didier (25).

Final average compensation is defined to mean average monthly compensation during sixty consecutive months which produce the highest average out of the last 120 consecutive months. The "normal retirement benefit" is equal to 1½% of an employee's final average compensation multiplied by the employee's "credited service" (one month for each calendar month during which the employee is compensated as a participant under the Pension Plan), at normal retirement date, with a maximum of 35 years, less 1$\frac{3}{7}$% of the employee's monthly Social Security benefit multiplied by the participant's credited service at normal retirement date, up to a maximum of 35 years. In addition, an employee may receive an early retirement benefit if he or she has attained age 55 and has at least five years of vesting service. The retirement benefit can be reduced to a minimum of 52% of the regular retirement benefit, depending upon the number of years of service the employee has within the Pension Plan. Covered compensation for the Pension Plan includes all compensation, including a portion of the annual incentive compensation, the "target award," and shift differential and overtime, but it excludes any employee's credits under any flexible benefit program under Section 125 of the Code. In addition, covered compensation excludes any contributions made to the ESOP or the Profit Sharing Plan, except for elective pre-tax contributions to the Profit Sharing Plan by employees. The Pension Plan is also designed to provide a survivor's benefit in the event of the employee's death. In the event of disability, benefits continue to accrue. Benefits are computed on a straight life annuity. Unless the employee elects otherwise (with spousal consent), the benefits are paid in the form of a qualified joint and survivor annuity benefit (with a 100% benefit during the employee's life and a 50% survivor benefit). If the employee elects otherwise, the benefits may be paid in a life-only option, five or ten-year certain and life option, a 66⅔% or a 100% joint and contingent annuitant option, and any other options adopted by the Pension Administrative Committee. Unless an employee elects otherwise, benefits are paid in the form of the life annuity. The Trustee of the Pension Plan is American National Bank and Trust Company, which is not an affiliate of the Company.

Other Qualified Plans and the Supplementary Retirement Income Plan

Prior to January 1, 1989, the Company sponsored the Otto Bremer Foundation/Bremer Financial Corporation Pension Plan, which was a defined benefit plan, and the Bremer Financial Corporation Disability and Retirement Plan, which was a defined contribution plan. These plans covered certain employees of the Company who did not participate in the Pension Plan and the Profit Sharing Plan. Because of governmental limitations on the maximum pension benefits payable and allowable under the Pension Plan and the Profit Sharing Plan, the Company established in 1987 the Bremer Financial Corporation Supplemental Retirement Income Plan (the "SRIP Plan") to provide those benefits that could not be paid from the qualified plans. All benefits payable under the Otto Bremer Foundation/Bremer Financial Corporation Pension Plan and Bremer Financial Corporation Disability and Retirement Plan were merged into the Pension Plan and the Profit Sharing Plan, respectively, on January 1, 1989. In 1988, the Company made a contribution to the Bremer Financial Corporation Disability and Retirement Plan for the benefit of Mr. Robert J. Reardon. In addition, $33,420 was segregated in a Rabbi Trust for Mr. Reardon at December 31, 1987.

Certain Transactions

Bremer Financial has employment agreements with Messrs. Terry M. Cummings, Duaine C. Espegard, Kenneth P. Nelson, A.D. Didier, Gene H. Sipe, William B. Naryka, Robert J. Hall and Charles D. Hendrickson (the "Bremer Financial Agreements"). All of the Bremer Financial Agreements provide for an employment term expiring December 31, 1992, with the exception of Mr. Didier's employment agreement, which expires July 31, 1989. However, employment may be terminated at an earlier date under the Bremer Financial Agreements upon the willful failure or refusal of the officer to perform his duties; at Bremer Financial's election, upon the inability of the officer to perform his duties for a period in excess of 180 consecutive days as a result of accident, illness, or other disability; or upon the officer's death. The Bremer Financial Agreements provide that the base salary paid in any year cannot be less than the base salary paid in the previous year.

The Subsidiary Banks have had, and expect to have in the future, banking transactions in the ordinary course of business with some directors and officers of the Company and directors of a significant subsidiary (including the Subsidiary Banks) or to an associate of such person. Such transactions have been and will be made on substantially the same terms, including interest rates on loans and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not and will not involve more than normal risk of collectability. The dollar amount of these loans was $9.2 million at December 31, 1987 and $9.3 million at December 31, 1988. During 1988, $3.2 million of new loans were made, repayments totalled $6.1 million, and no loans to a related person were restructured to provide for a deferral of payments and/or a reduction in interest rates.

PRINCIPAL SHAREHOLDERS

As of the date of this Prospectus, the Foundation was the sole beneficial owner of the Company's capital stock. The Foundation owned as of such date all of the 1,200,000 issued and outstanding shares of Class A Common Stock and all of the 10,800,000 issued and outstanding shares of Class B Common Stock. After the sale of 960,000 shares of Class A Common Stock by the Foundation in this offering, the Foundation will own 240,000 shares of Class A Common Stock, representing 20% of such issued and outstanding shares, and 10,800,000 shares of Class B Common Stock, representing 100% of such issued and outstanding shares.

DESCRIPTION OF CAPITAL STOCK

The Company's authorized capital stock consists of 12,000,000 shares of Class A Common Stock, no par value, and 10,800,000 shares of Class B Common Stock, no par value. These classes of capital stock are described below.

Description of Class A Common Stock

As of the date of this Prospectus, and after this offering, there are and will be 1,200,000 shares of Class A Common Stock outstanding. Further, as of the date of this Prospectus, the only shareholder was the Foundation. Because all of the 960,000 shares of Class A Common Stock being sold pursuant to this offering are being sold by the Foundation, there will be 1,200,000 shares of Class A Common Stock outstanding after the offering. There are no outstanding options or warrants to purchase Class A Common Stock. However, upon the occurrence of a "Conversion Event" (as that term is defined below), each of the 10,800,000 shares of Class B Common Stock may be converted into a share of Class A Common Stock at the affirmative election of the holder of the Class B Common Stock. In addition, and as described below, the Company and the Foundation would have in certain circumstances an option to purchase presently outstanding shares of Class A Common Stock.

Each holder of shares of Class A Common Stock is entitled to one vote per share on all matters to be voted on by shareholders. Because there are no cumulative voting rights, the holders of shares entitled to exercise more than 50% of the voting rights in the election of directors are able to elect 100% of the directors.

The holders of shares of Class A Common Stock are entitled to dividends and other distributions as and when declared by the Company's Board of Directors out of funds legally available therefor. Upon the liquidation, dissolution, or winding up of the Company, the holder of each share of Class A Common Stock would be entitled to share pro rata in a distribution of all of the Company's available assets along with the other holders of shares of Class A Common Stock and Class B Common Stock. The holders of Class A Common Stock are not entitled to preemptive rights to purchase shares of Class A Common Stock, Class B Common Stock, or any other securities of the Company by law or under the Company's Articles of Incorporation. Shares of Class A Common Stock are not subject to any redemption or sinking fund provisions and are not convertible into any other security or other property of the Company. The Class A Common Stock presently outstanding is and will be upon completion of the offering fully paid and non-assessable. No share of Class A Common Stock is subject to any further call or assessment.

Restrictions on Transfer. The Company will have an option to purchase all shares of Class A Common Stock sold in this offering upon the later resale of such shares, as described below. If the Company does not exercise its option, shares of Class A Common Stock may be sold only if (i) the purchaser agrees in writing to be bound by the rights, restrictions, and limitations with respect to the Class A Common Stock set forth in the Plan of Reorganization, and (ii) the purchaser provides an opinion of counsel satisfactory to the Company that the sale has been registered under the Securities Act of 1933 and applicable state securities laws or that an exemption from registration is available. In addition, the certificates evidencing all shares of Class A Common Stock sold in the offering will bear a legend setting forth these restrictions on transfer and which contains essentially the following language:

> The sale, transfer and encumbrance of the certificate is restricted by the Company's Articles of Incorporation and the Plan of Reorganization dated February 8, 1989, which provide for, among other things, an option to purchase granted in favor of the Company, Otto Bremer Foundation and/or their transferees or designated assignees at a formula price. A copy of the Plan of Reorganization is available for inspection in the Company's business office.

First Put Option to Shareholders. Upon the sale of all or substantially all of the shares of Class B Common Stock held by the Foundation, each holder of Class A Common Stock will have the right to sell all of his or her shares of Class A Common Stock to the Foundation or its designated assignee for a total cash purchase price per share equal to the average sales price per share realized by the Foundation for the sale of its Class A Common Stock and Class B Common Stock (the "First Put Option"). The First Put Option is effective commencing with the date upon which the Foundation and the transferee execute a definitive purchase agreement for the sale and purchase of the Class B Common Stock and continues for a period of thirty days after the date on which the holder of the Class A Common Stock receives written notice from the Foundation of the event giving rise to the First Put Option. The holder of the Class A Common Stock must exercise the First Put Option by providing written notice thereof to the Foundation, its assignee, or the transferee, as the case may be, at any time during the option period. The date of closing of the purchase and sale of Class A Common Stock to be sold pursuant to the exercise of the First Put Option will be determined by the party purchasing such Class A Common Stock, provided, however, that the closing must occur on or before a date sixty days after the closing date of the sale of the Class B Common Stock by the Foundation to the transferee or such later date as is reasonably required to obtain any necessary regulatory approvals relative to such purchase.

Second Put Option to Shareholders. Upon the occurrence of the following events (the "Put Events"), each holder of Class A Common Stock, subject to the limitations provided below, will have the right to require the Company or the Company's designated assignee to purchase all shares of Class A Common Stock then owned by such holder (the "Second Put Option"): (i) if the shares of Class A Common Stock were distributed to the holder from the Company's ESOP and the shareholder is a former participant in the ESOP, at the affirmative election of such shareholder at any time within fifteen months subsequent to such distribution, provided, however, that the Second Put Option applies only to the Class A Common Stock received in the distribution and not to any other Class A Common Stock owned by such former participant; and (ii) if the holder of the Class A Common Stock (other than that received pursuant to a distribution from the ESOP) is an employee of the Company, upon the death, "permanent disability," or retirement at "normal retirement age" (that is, 65 years of age) of such holder. For purposes of the Second Put Option, the terms "permanent disability" and "normal retirement age" have the same respective meanings set forth in the qualified employee retirement plans maintained by the Company for the benefit of its employees. See "Management — Compensation Pursuant to Plans."

The owner of the Class A Common Stock or his or her executors, administrators or personal representatives may exercise the Second Put Option at any time within ninety days subsequent to the occurrence of a Put Event by providing written notice thereof to the Company. The purchase price for the Class A Common Stock being sold pursuant to the exercise of the Second Put Option must be paid in cash and will be equal to the following: (i) for Class A Common Stock sold pursuant to the exercise of a Second Put Option being exercised by a former ESOP participant with respect to shares distributed by the ESOP, the price per share would be equal to the fair market value of the Class A Common Stock as established by the most recent annual appraisal (the "Fair Market Value"); and (ii) for Class A Common Stock sold pursuant to a Second Put Option exercised by or on behalf of an employee of the Company, the price per share would be equal to the book value per share shown on the Company's consolidated financial statements dated as of the last day of the immediately preceding fiscal quarter. The closing of the purchase and sale of shares of Class A Common Stock upon the exercise of a Second Put Option is to occur within 120 days subsequent to the shareholder's exercise thereof, or such longer period as is reasonably required to obtain any necessary regulatory approvals relative to such purchase.

Notwithstanding the foregoing, the Company is not obligated to repurchase any Class A Common Stock pursuant to the exercise of a Second Put Option if the consideration for such purchase, when added to the consideration paid by the Company for all previous purchases of Class A Common Stock during the preceding twelve-month period, would exceed 10% of the Company's net worth as of the date of such purchase. Under the Holding Company Act as currently enacted, the Company must obtain the prior approval of the Federal Reserve Board if the Company redeems shares of Class A Common Stock and the consideration paid for such shares, when added to the consideration paid by the Company for all previous redemptions of Class A Common Stock during the preceding twelve-month period, exceeds 10% of the Company's net worth. See "Supervision and Regulation — Regulation of Company."

First Call Option to Company. Upon the occurrence of the following events (the "Option Events"), the Company or its designated assignee will have an option to purchase the Class A Common Stock (the "First Call Option"): (i) the holder of the Class A Common Stock proposes to dispose of or transfer such shares or any interest therein to any third party or entity in a voluntary or an involuntary transfer; (ii) the death of a holder of Class A Common Stock, if such holder is a natural person; or (iii) if the holder of the Class A Common Stock is an employee of the Company, upon the retirement or termination of employment of such holder. Upon the occurrence of an Option Event, the holder of the Class A Common Stock or his or her executor, administrator or personal representative (in the case of the shareholder's death) is to provide written notice thereof to the Company. The First Call Option exists from the effective date of the Option Event and will continue until sixty days after the Company's receipt of written notice of the Option Event giving rise thereto (with the exception that the First Call Option does not apply to distributions from the ESOP pursuant to Option Events (ii) and (iii) above and then exists for only fourteen days for Class A Common Stock distributed from the ESOP for Option Event (i)). Within such option period, the Company or its assignee has the option to purchase the Class A Common Stock for a cash purchase price equal to the book value per share of the Class A Common Stock as shown on the Company's consolidated balance sheet dated as of the last day of the immediately preceding fiscal quarter (except for shares purchased from an individual which were received as part of a distribution from the ESOP, in which event the purchase price will be equal to the greater of the price offered by any potential third party transferee or the Fair Market Value as determined by the most recent annual appraisal). If the Company or its assignee does not exercise the First Call Option within the option period, the holder of the Class A Common Stock or his or her executors, administrators, or personal representatives has the right to transfer the shares of Class A Common Stock in their sole discretion; provided, however, that any subsequent purchaser must take the Class A Common Stock subject to all of the rights, restrictions and limitations set forth in the Plan of Reorganization. The closing of the purchase and sale of the Class A Common Stock upon the exercise of the First Call Option must occur within 120 days after the exercise thereof by the Company or its assignee, or such longer period as is reasonably required to obtain any necessary regulatory approvals relative to such purchase.

Second Call Option to Foundation. Upon the sale of all or substantially all of the shares of Class B Common Stock held by the Foundation, the Foundation, its designated assignee or the transferee of such shares will have the right to purchase all shares of Class A Common Stock then outstanding (the "Second Call Option") at a cash purchase price equal to the greater of: (i) the book value per share as set forth on the Company's consolidated balance sheet dated as of the last day of the immediately preceding fiscal quarter; (ii) the average price per share realized by the Foundation for the sale of its Class A Common Stock and Class B Common Stock; or (iii) with respect to any Class A Common Stock owned by the ESOP or any stock owned by a former ESOP participant, which stock was distributed from the ESOP to such participant within the preceding fifteen months, the Fair Market Value of such Class A Common Stock as of the date of purchase. The Second Call Option is effective upon written notice thereof on or subsequent to the date upon which the Foundation and the transferee execute a definitive purchase agreement for the purchase and sale of the Class B Common Stock and continues for a period of sixty days after the effective date of sale of the Class B Common Stock. The Foundation, its assignee, or the transferee must exercise the Second Call Option by providing written notice thereof to the holders of the Class A Common Stock at any time during the option period. The closing of the purchase and sale of the Class A Common Stock upon the exercise of the Second Call Option is to occur within 120 days subsequent to the exercise thereof by the Foundation, its assignee or the transferee, or such longer period as is reasonably required to obtain any necessary regulatory approvals relative to such purchase and sale.

Put Option to Non-Employee Directors and Call Option to Company. The Company may agree with individual non-employee directors of Subsidiary Banks who purchase shares of Class A Common Stock to grant to such a director a put option that would allow the director to require the Company or the Company's designated assignee to purchase all shares of Class A Common Stock then owned by such director when he or she ceases to be a director with the Subsidiary Bank. However, it is anticipated that the Company would not grant a put option to any Subsidiary Bank director unless the director also granted to the Company a call option that would allow the Company or its designated assignee to purchase all of the director's shares of Class A Common Stock when the director ceases to be a director with the Subsidiary Bank. The exercise price per share of the put option and the call option would be equal to the book value per share shown on the Company's consolidated financial statements dated as of the last day of the immediately preceding fiscal quarter and would be subject to the same conditions and terms as the exercise of the Second Put Option.

Restrictions on Issuance of Class A Common Stock. The Company has agreed to reserve and keep available and unissued such number of shares of Class A Common Stock equal to the maximum number of shares of Class B Common Stock which could be converted into Class A Common Stock. As of the date of this Prospectus, the 10,800,000 shares of Class B Common Stock outstanding could be converted into 10,800,000 shares of Class A Common Stock, and there were 10,800,000 shares of Class A Common Stock authorized but not issued or outstanding. Therefore, unless the Company's Articles of Incorporation are amended to increase the number of authorized shares of Class A Common Stock, the Company can issue no shares of Class A Common Stock as dividends, for financing, or otherwise. The holders of Class B Common Stock would be entitled to vote on any such amendment. See "Description of Capital Stock—Description of Class B Common Stock."

Transfer of Shares by Foundation. The Foundation has the unrestricted legal right, subject to applicable state and federal securities and banking laws, to transfer its shares of Class A Common Stock and Class B Common Stock to any third party or entity, other than a disqualified person with respect to the Foundation (as that term is defined in Section 4946(a) of the Code). See "Plan of Reorganization." However, upon each transfer of Class A Common Stock by the Foundation, the transferee thereof must execute and deliver to the Foundation a Subscription Agreement containing an express acknowledgment by such transferee that the shares of Class A Common Stock are subject to the provisions regarding such Class A Common Stock set forth in the Plan of Reorganization and the Company's Articles of Incorporation, including the First Call Option, the Second Call Option, the First Put Option, the Second Put Option, and the restrictions on further transfer described above.

Description of Class B Common Stock

With the exception of the difference in voting rights that is hereinafter described, the shares of Class B Common Stock have all of the same rights and privileges and rank equally, share ratably, and are identical in all respects to the rights accorded to the shares of Class A Common Stock, including the right to share equally in any dividends declared by the Company and the right to share equally in any liquidation proceeds of the Company. However, and except with respect to an "Extraordinary Transaction" (as that term is defined below), the holders of Class B Common Stock are not entitled to vote on any issue properly subject to a vote by the shareholders of the Company. The holders of Class B Common Stock do have the right to vote on an equivalent per share basis with the holders of Class A Common Stock with respect to the following extraordinary corporate transactions (the "Extraordinary Transactions"): (i) any vote of the Company's shareholders regarding a merger, consolidation, liquidation, or dissolution of the Company or a proposed sale of all or substantially all of the Company's assets; (ii) any vote regarding the amendment of the Company's Articles of Incorporation purporting to change the capital structure of the Company or the voting power of the Class A Common Stock or the Class B Common Stock, including, but not limited to, any vote regarding the authorization of additional shares of Class A Common Stock or Class B Common Stock or any vote regarding the authorization of additional classes of stock. Unless waived by the holders of Class B Common Stock in writing, the Company is required to provide thirty days' prior written notice to the holders of the Class B Common Stock that a vote regarding an Extraordinary Transaction is to occur at any properly noticed annual or special meeting of the Company's shareholders.

Upon the occurrence of any of the following events (the "Conversion Events"), each share of Class B Common Stock that is the subject of the Conversion Event may be converted into one fully paid and nonassessable share of Class A Common Stock: (i) upon the affirmative election of the transferee if shares of Class B Common Stock are transferred by the Foundation to any third party or entity; or (ii) at the affirmative election of the holder of the Class B Common Stock if cash dividends, calculated as hereinafter described, have not been paid on the Class A Common Stock and the Class B Common Stock in any fiscal year of the Company (beginning in 1989) in an amount equal to at least 5% of the Company's consolidated net book value as of the last day of the immediately preceding fiscal year (beginning with 1988) (the "Minimum Annual Return"). For purposes of calculating the Minimum Annual Return, the consolidated net book value of the Company for any fiscal year means the total net book value as of the last day of the immediately preceding fiscal year as set forth in the Company's audited consolidated balance sheet prepared in accordance with generally accepted accounting principles, consistently applied. The cash dividends to be included for purposes of calculating the Minimum Annual Return are all cash dividends paid with respect to the Class A Common Stock and the Class B Common Stock during the applicable fiscal year of the Company. However, no cash distributions are to be included in determining the Minimum Annual Return to the extent that such distributions exceed the amount of the Company's consolidated net income for the applicable fiscal year as set forth in the Company's audited consolidated statement of income for such year exclusive of any income or gain resulting from the sale of stock of any of the Company's subsidiaries or from the sale of all or substantially all of the assets of any of the Company's subsidiaries.

Shares Eligible for Future Sale

The Company presently has and will have upon completion of the offering 1,200,000 shares of Class A Common Stock issued and outstanding and 10,800,000 shares of Class B Common Stock issued and outstanding. The 960,000 shares of Class A Common Stock sold in the offering will be tradeable under the Securities Act of 1933 (the "1933 Act"), subject to the restrictions on transfer and the First Call Option and Second Call Option described above.

The remaining 240,000 outstanding shares of Class A Common Stock are held by the Foundation and may not be sold unless they are registered under the 1933 Act or sold pursuant to Rule 144 under the 1933 Act or other exemptions. The 10,800,000 shares of Class B Common Stock held by the Foundation can be sold only if registered under the 1933 Act or if an exemption from registration is available. Upon any conversion of the shares of Class B Common Stock into shares of Class A Common Stock, the resulting shares of Class A Common Stock could be sold pursuant to Rule 144 under the 1933 Act or other exemptions. In general, under Rule 144 as currently in effect, a person who has beneficially owned restricted shares for at least two years, including the Foundation and other persons who are affiliates of the Company, are entitled to sell within any ninety-day period a number of shares of Class A Common Stock which does not exceed the greater of either the average weekly trading volume during the four calendar weeks preceding such sale or 1% of the then-outstanding shares of Class A Common Stock. As of the date of this Prospectus, 1% of the outstanding shares of the Class A Common Stock was equal to 12,000 shares. A person who is not an affiliate of the Company, who has not been an affiliate of the Company during the ninety days preceding a sale by such person, and who has beneficially owned restricted shares of Class A Common Stock for at least three years, would be entitled to sell all of such shares of Class A Common Stock under Rule 144 without regard to these volume limitations. The Company believes that, under Rule 144, the 240,000 shares of Class A Common Stock held by the Foundation would be eligible for sale beginning in February 1991, subject to the volume limitations of Rule 144 discussed above.

Prior to this offering, there was no established market for the Class A Common Stock, and no predictions can be made of the effect, if any, that sales of shares of Class A Common Stock or the availability of shares for sale will have on the market price prevailing from time to time. Nevertheless, sales of substantial numbers of shares of Class A Common Stock in the market may have an adverse impact on the market price.

Transfer Agent

First American Trust Company of Minnesota, a wholly-owned subsidiary of the Company, is the registrar and transfer agent for the Company's Class A Common Stock and Class B Common Stock. See "Business — Financial Service Subsidiaries."

PLAN OF DISTRIBUTION

Plan of Distribution

The Foundation is offering pursuant to this Prospectus 960,000 shares of the Company's Class A Common Stock at a price of $11.24 per share on a best efforts basis. See "Description of Capital Stock." The Foundation has been the sole shareholder of the Company at all times since and including February 15, 1951 and will be the sole shareholder until the sale of shares of Class A Common Stock in the offering described in this Prospectus. The relationship between the Foundation and the Company is described in the portion of this Prospectus entitled "The Company and the Foundation." After the sale of 960,000 shares of Class A Common Stock in this offering, the Foundation will own 20% of the outstanding shares of Class A Common Stock, 100% of the outstanding shares of Class B Common Stock, and 92% of all outstanding shares of the Company's capital stock, which consists of the Class A Common Stock and the Class B Common Stock. All of the 960,000 shares of Class A Common Stock sold in the offering are being sold for the account of the Foundation.

The offering of the shares of the Company's Class A Common Stock is being made by the Foundation on a best efforts basis. Where permitted by law, the offering will be made through certain officers and employees of the Company and certain Subsidiary Banks, who will receive no commissions or special compensation, directly or indirectly, for so acting. No underwriter will be involved. However, where required by applicable state law, the offering will be made through a licensed broker-dealer. The Company's shares of Class A Common Stock will be offered for a period ending at 5:00 p.m., St. Paul, Minnesota time, on May 22, 1989. There is no assurance that all shares of Class A Common Stock will be sold in the offering. If fewer than 960,000 shares are sold before the termination of the offering period, the Foundation may divest of shares of Class A Common Stock by other methods to meet the divestiture requirements of Section 4943 of the Code, which methods may include donating shares to various charities.

Prior to its receipt of funds from the sale of the shares of Class A Common Stock, the Foundation may reject subscriptions for shares in whole or in part at its discretion, regardless of when or whether such subscriptions were previously accepted by the Foundation. The Foundation may withdraw or modify the terms of this offering at any time without notice. In addition, there may be restrictions on the maximum number of shares of Class A Common Stock that may be purchased in this offering by any investor based upon the total number of shares for which subscriptions are received. However, no individual investor may purchase in this offering more than 5% of the outstanding shares of Class A Common Stock (or 60,000 shares). The minimum purchase in this offering is 50 shares.

Determination of Offering Price

Prior to this offering, there was no public market for the shares of Class A Common Stock of the Company. The offering price of the Class A Common Stock offered hereby is equal to the unaudited book value of such Class A Common Stock on March 31, 1989, as determined by the Company's management. Prior to any sale of shares of Class A Common Stock to the ESOP, Piper, Jaffray & Hopwood Incorporated will render a fairness opinion to the ESOP with respect to the shares being sold it.

Purchase of Shares Through Profit Sharing Plan

All of the participants in the Profit Sharing Plan are eligible to invest all or a portion of their vested account balances in shares of Class A Common Stock. Any such investments will be done only at the direction of a participant. All such shares purchased at the direction of the participants will be registered in the name of the Trustee of the Profit Sharing Plan, with the appropriate number of shares of Class A Common Stock allocated to the account of each such participant. However, shares of Class A Common Stock purchased through the Profit Sharing Plan can be voted by the participants in the Profit Sharing Plan. See "Management — Compensation Pursuant to Plans — Profit Sharing Plan." Subject to availability and demand, each participant in the Profit Sharing Plan may elect to purchase additional shares or sell shares twice each year. No Class A Common Stock will be purchased by the Profit Sharing Plan except at the direction of a participant. The election to invest in the Class A Common Stock is completely voluntary.

Participants in the Profit Sharing Plan who want to subscribe to invest all or a portion of their vested account balances in shares of Class A Common Stock in this offering should complete Appendix A, read Part IV, and sign the Bremer Financial Corporation Stock Order Form provided with this Prospectus and return it to the Company as provided therein.

Purchase of Shares of Class A Common Stock With Own Funds

Persons who want to subscribe for shares of Class A Common Stock and use their own funds to purchase such shares in this offering should complete Part II, read Part IV, and sign the Bremer Financial Corporation Stock Order Form provided with this Prospectus and return it to the Company as provided therein.

Purchase of Shares of Class A Common Stock by ESOP

The ESOP is designed to invest in "qualifying employer securities," including shares of the Company's Class A Common Stock. The ESOP intends to borrow the necessary funds from a commercial lending source other than the Company or any of its affiliates to enable it to purchase shares of Class A Common Stock in the offering. Pursuant to applicable provisions of the Code and the Treasury Regulations promulgated thereunder, all shares of Class A Common Stock purchased with such borrowed funds will initially be held within the ESOP in a "suspense account" and will not be allocated to the accounts of the participants. As the loan to the ESOP is repaid, a portion of the Class A Common Stock will be released each year from the suspense account and allocated to the accounts of the ESOP participants. The allocation is done on the basis of the individual's covered compensation for that year compared to the total covered compensation of all participants for that year. All of the Class A Common Stock will be registered in the name of the Trustee of the ESOP. Shares in the ESOP will be voted as described in "Management — Compensation Pursuant to Plans — Employee Stock Ownership Plan."

EXPERTS

The consolidated balance sheets of the Company as of December 31, 1987 and 1988, the related consolidated statements of income and changes in shareholder's equity for each of the three years in the period ended December 31, 1988, the consolidated statements of changes in financial position for the years ended December 31, 1986 and 1987, and the consolidated statement of cash flows for the year ended December 31, 1988, included in this Prospectus, have been included herein in reliance on the report of Coopers & Lybrand, independent certified public accountants, given on the authority of that firm as experts in accounting and auditing.

LEGAL MATTERS

The validity of the issuance of the shares of Class A Common Stock offered hereby will be passed upon for the Company by Winthrop & Weinstine, 3200 Minnesota World Trade Center, 30 East Seventh Street, St. Paul, Minnesota 55101.

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT ACCOUNTANTS

We have audited the accompanying consolidated balance sheets of Bremer Financial Corporation, a wholly owned subsidiary of the Otto Bremer Foundation, and Subsidiaries as of December 31, 1987 and 1988, and the related consolidated statements of income and changes in shareholder's equity for each of the three years in the period ended December 31, 1988, the consolidated statements of changes in financial position for the years ended December 31, 1986 and 1987, and the consolidated statement of cash flows for the year ended December 31, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Bremer Financial Corporation and Subsidiaries as of December 31, 1987 and 1988, the consolidated results of their operations for each of the three years in the period ended December 31, 1988, the consolidated changes in their financial position for the years ended December 31, 1986 and 1987, and their consolidated cash flows for the year ended December 31, 1988 in conformity with generally accepted accounting principles.

As discussed in Note A to the consolidated financial statements, the Company included a consolidated statement of cash flows in 1988 in place of a consolidated statement of changes in financial position and has elected not to restate prior years' financial statements.

COOPERS & LYBRAND

St. Paul, Minnesota
February 28, 1989

BREMER FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets
December 31, 1987 and 1988
(Dollar amounts in thousands)

	1987	1988
Assets		
Cash and due from banks	$ 84,238	$ 77,895
Interest bearing deposits	21,751	14,314
Federal funds sold	29,136	20,066
Investment securities (market value of $482,402 and $515,636 at December 31, 1987 and 1988, respectively)	480,836	522,096
Loans	964,422	1,026,584
Less:		
Reserve for loan losses	17,203	18,490
Unearned discount	1,017	715
Net loans	946,202	1,007,379
Premises and equipment	28,009	27,158
Interest receivable	19,939	22,337
Other assets	13,935	11,128
Total assets	$1,624,046	$1,702,373
Liabilities and Shareholder's Equity		
Deposits:		
Noninterest bearing	$ 196,857	$ 185,598
Interest bearing	1,212,750	1,288,683
Total deposits	1,409,607	1,474,281
Federal funds purchased and repurchase agreements	46,763	53,794
Treasury tax and loan notes	4,590	4,467
Other short-term borrowings	5,000	—
Accrued expenses and other liabilities	23,441	25,048
Long-term debt	5,117	4,015
Total liabilities	1,494,518	1,561,605
Minority interests	8,169	8,435
Commitments		
Shareholder's equity		
Common stock:		
Class A, no par, 12,000,000 shares authorized; 1,200,000 shares issued and outstanding	285	285
Class B, no par, 10,800,000 shares authorized, issued and outstanding	2,562	2,562
Retained earnings	118,512	129,486
Total shareholder's equity	121,359	132,333
Total liabilities and shareholder's equity	$1,624,046	$1,702,373

The accompanying notes are an integral part of the consolidated financial statements.

BREMER FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income
Years Ended December 31, 1986, 1987 and 1988
(In thousands except per share amounts)

	1986	1987	1988
Interest income			
Loans, including fees	$103,315	$ 99,758	$104,446
Investment securities			
Taxable	32,243	32,699	36,262
Nontaxable	6,626	5,633	5,190
Federal funds sold	2,159	1,034	1,464
Other	2,960	2,349	2,069
Total interest income	147,303	141,473	149,431
Interest expense			
Deposits	81,543	72,927	77,350
Federal funds purchased and repurchase agreements	3,143	2,549	3,949
Other short-term funds borrowed	1,298	1,020	600
Long-term debt	751	494	415
Total interest expense	86,735	76,990	82,314
Net interest income	60,568	64,483	67,117
Provision for loan losses	15,063	8,811	6,418
Net interest income after provision for loan losses	45,505	55,672	60,699
Noninterest income			
Service charges	6,443	6,597	6,708
Insurance	3,353	3,422	3,921
Trust	2,283	2,722	2,809
Investment securities gains	9,218	1,203	59
Other	3,148	5,290	4,644
Total noninterest income	24,445	19,234	18,141
Noninterest expense			
Salaries and wages	25,321	25,891	26,705
Employee benefits	5,309	6,883	7,044
Occupancy	3,543	3,758	4,218
Furniture and equipment	4,012	5,353	5,478
Other	19,675	17,431	16,221
Total noninterest expense	57,860	59,316	59,666
Income before income tax expense	12,090	15,590	19,174
Income tax expense	1,056	2,901	4,300
Net income	$ 11,034	$ 12,689	$ 14,874
Net income per common share	$ 0.92	$ 1.06	$ 1.24

The accompanying notes are an integral part of the consolidated financial statements.

BREMER FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Financial Position
Years Ended December 31, 1986 and 1987
(In thousands)

	1986	1987
Sources of Funds		
From operations:		
Net income	$ 11,034	$12,689
Items not requiring (providing) funds:		
Provision for loan losses	15,063	8,811
Depreciation and amortization	3,007	3,105
Deferred income taxes	312	(793)
Minority interests in earnings of subsidiaries	1,083	822
Other	(825)	(877)
Total provided from operations	29,674	23,757
Increases in:		
Deposits	52,575	22,529
Federal funds purchased and repurchase agreements	9,223	—
Treasury tax and loan notes	—	380
Decreases in:		
Interest bearing deposits	—	12,870
Federal funds sold	27,805	—
Investment securities	—	2,310
Interest receivable	4,840	3,742
Other assets	—	3,611
Total sources of funds	124,117	69,199
Applications of Funds		
Increases in:		
Interest bearing deposits	13,483	—
Federal funds sold	—	10,021
Investment securities	51,133	—
Loans, net	21,596	39,741
Premises and equipment	3,677	2,842
Decreases in:		
Federal funds purchased and repurchase agreements	—	11,036
Treasury tax and loan notes	106	—
Other short-term borrowings	8,878	4,700
Accrued expenses and other liabilities	2,720	1,596
Long-term debt	2,990	1,279
Minority interests acquired	3,211	136
Dividends paid	3,569	4,428
Other	860	—
Total applications of funds	112,223	75,779
Increase (decrease) in cash and due from banks	11,894	(6,580)
Cash and due from banks		
Beginning of year	78,924	90,818
End of year	$ 90,818	$84,238

The accompanying notes are an integral part of the consolidated financial statements.

BREMER FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statement of Cash Flows
Year Ended December 31, 1988
(In thousands)

	1988
Cash flows from operating activities:	
Net income	$ 14,874
Adjustments to reconcile net income to net cash provided by operations:	
Provision for loan losses	6,418
Depreciation of premises and equipment	3,030
Minority interests in earnings of subsidiaries	950
Other amortization	(876)
Investment security gains	(59)
Deferred income taxes	(1,544)
Interest receivable	(2,398)
Other assets, net	4,351
Other accrued expenses and liabilities, net	2,483
Net cash provided by operating activities	27,229
Cash flows from investing activities:	
Deposits in other banks, net	7,437
Federal funds sold, net	9,070
Purchases of investment securities	(259,785)
Proceeds from sale of investment securities	218,584
Loans originated or acquired	(1,044,956)
Loan principal collected	977,361
Acquisition of premises and equipment	(2,179)
Net cash used by investing activities	(94,468)
Cash flows from financing activities:	
Noninterest bearing deposits, net	(11,259)
Interest bearing deposits (excluding certificates of deposit), net	14,583
Proceeds from issuance of certificates of deposit	965,208
Payments for maturing certificates of deposit	(903,858)
Federal funds purchased and repurchase agreements, net	7,031
Other short-term borrowings, net	(5,123)
Repayments of long-term debt	(1,102)
Minority interest acquired	(28)
Dividends paid	(4,556)
Net cash provided by financing activities	60,896
Net decrease in cash and due from banks	(6,343)
Cash and due from banks	
Beginning of year	84,238
End of year	$ 77,895
Supplemental disclosures of cash flow information:	
Cash paid during the year for:	
Interest	$ 79,529
Income taxes	4,437

The accompanying notes are an integral part of the consolidated financial statements.

BREMER FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholder's Equity
Years Ended December 31, 1986, 1987, and 1988
(In thousands except per share amounts)

	Common Stock A	Common Stock B	Retained Earnings	Total
Balance, December 31, 1985	$285	$2,562	$101,589	$104,436
Net income	—	—	11,034	11,034
Dividends, $.25 per share	—	—	(3,000)	(3,000)
Balance, December 31, 1986	285	2,562	109,623	112,470
Net income	—	—	12,689	12,689
Dividends, $.32 per share	—	—	(3,800)	(3,800)
Balance, December 31, 1987	285	2,562	118,512	121,359
Net income	—	—	14,874	14,874
Dividends, $.33 per share	—	—	(3,900)	(3,900)
Balance, December 31, 1988	$285	$2,562	$129,486	$132,333

The accompanying notes are an integral part of the consolidated financial statements.

Notes to Consolidated Financial Statements

Note A: Accounting Policies

Consolidation — The consolidated financial statements include the accounts of the Company (a bank holding company wholly owned by Otto Bremer Foundation) and all banks and financial service subsidiaries in which the Company has a majority interest. All significant intercompany accounts and transactions have been eliminated. The significant accounting principles followed by the Company are summarized below:

Cash Flows — Effective January 1, 1988, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 95 "Statement of Cash Flows," which requires companies to include a statement of cash flows rather than a statement of changes in financial position when issuing a complete set of financial statements. The Company has elected not to restate prior years' financial statements. For purpose of this statement, the Company has defined cash equivalents as cash and due from banks.

Securities — Investment securities are stated at cost, increased for accretion of discounts and reduced by amortization of premiums, computed by the constant-yield method. Gains or losses on sales of investment securities are computed based on the adjusted cost of the specific securities sold and are recognized in the year of sale.

Loans — Interest income is accrued on loan balances based on the principal amount outstanding. Loans are reviewed regularly by management and placed on nonaccrual status when the collection of interest or principal is unlikely. Thereafter, no interest is recognized as income unless received in cash or until such time the borrower demonstrates the ability to pay interest and principal.

Effective January 1, 1988, the Company adopted Statement of Financial Accounting Standards No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases." This pronouncement requires that certain net loan and commitment fees be deferred and amortized over the life of the related loan or commitment as an adjustment of yield. Previously these fees were recognized when received. The Company has elected not to restate prior years' financial statements. The impact on net income for the year ended December 31, 1988 for this change in accounting principle was not significant.

Reserve for Loan Losses — Management determines the adequacy of the reserve based upon a continuous review of the loan portfolio through evaluation of the loan composition, economic conditions and other pertinent factors. The reserve is increased by provisions charged to expense and reduced by net charge-offs.

Premises and Equipment — Premises and equipment are stated at cost less accumulated depreciation and amortization computed principally on accelerated methods based on estimated useful lives.

Other Real Estate — Other real estate, which is included in other assets, represents properties acquired through foreclosure or other proceedings recorded at the lower of the amount of the loan satisfied or fair market value. Any write-down to fair market value at the time of foreclosure is charged to the reserve for loan losses. Property is appraised periodically to ensure that the recorded amount is supported by the current fair market value. Market write-downs, operating expenses and losses on sales are charged to other expenses. Income, including gains on sales, is credited to other income.

Income Taxes — Bremer Financial Corporation and subsidiaries file a consolidated federal tax return.

Certain items of income and expense are recognized in different periods for financial reporting purposes than for income tax purposes, resulting in differences between the tax basis of assets and liabilities and their financial reporting amounts. Deferred taxes are provided on such differences, primarily related to the differences between providing for loan losses for financial reporting purposes

Note A: Accounting Policies (continued)

while deducting charged-off loans for tax purposes, and the cash basis of accounting used for income tax purposes in prior years. Investment tax credits (ITC) in 1986 have been accounted for on the "flow through" method, which recognizes the benefit for financial reporting purposes in the year in which the benefit is utilized. The Tax Reform Act of 1986 eliminated the ITC for new purchases effective January 1, 1986. ITC used in 1986 resulted from asset additions qualifying under transition rules.

Earnings Per Share Calculations — Earnings per common share have been computed using 12,000,000 common shares for all periods. See Note L.

Reclassifications — Certain amounts have been reclassified to provide consistent presentation among the various accounting periods shown. The reclassifications have no effect on previously reported net income or total shareholder's equity.

Note B: Restrictions on Cash and Due From Banks

Subsidiary Banks are required to maintain average reserve balances with the Federal Reserve Bank. The amounts of those reserve balances were $27,846,000 and $25,469,000 at December 31, 1987 and 1988, respectively.

Note C: Investment Securities

The aggregate carrying amount and market value of investment securities at December 31 consist of the following (in thousands):

	1987		1988	
	Carrying Amount	Market Value	Carrying Amount	Market Value
U.S. Treasury securities	$131,415	$131,019	$160,409	$158,563
U.S. government agencies	156,341	156,368	107,802	106,731
State and political subdivisions	67,391	71,674	63,791	66,789
Collateralized mortgage obligations	106,050	103,696	102,438	97,931
Other taxable securities	19,639	19,645	87,656	85,622
	$480,836	$482,402	$522,096	$515,636

At December 31, 1987 and 1988, investment securities with a carrying value of $214,649,000 and $229,659,000, respectively, were pledged as collateral to secure public deposits and for other purposes.

Note D: Loans

Loans at December 31 consist of the following (in thousands):

	1987	1988
Commercial and other	$304,779	$ 335,391
Agricultural	186,322	192,054
Real Estate —		
Mortgage	283,113	295,022
Construction	11,879	14,937
Consumer	120,399	132,277
Tax exempt	57,930	56,903
	$964,422	$1,026,584

Note D: Loans (continued)

Nonperforming loans were $24,639,000 and $17,482,000 at December 31, 1987 and 1988, respectively. Nonperforming loans include nonaccrual and renegotiated loans. Renegotiated loans are those for which the terms have been modified (principal and interest) as a result of the inability of the borrower to meet the original terms of the loan.

Interest income on nonperforming loans that would have been earned had the loans performed in accordance with the original contractual agreements was approximately $3,595,000 and $2,621,000 for the years ended December 31, 1987 and 1988, respectively. Interest income actually recognized on nonperforming loans was approximately $1,002,000 and $921,000 for the years ended December 31, 1987 and 1988, respectively.

Other nonperforming assets, consisting of other real estate acquired through foreclosure, amounted to $5,304,000 and $3,895,000 at December 31, 1987 and 1988, respectively.

The Company and its subsidiaries have granted loans to the officers and directors (the "Group") of significant subsidiaries. The aggregate dollar amount of these loans to the Group was $9,150,000 and $9,281,000 at December 31, 1987, and 1988, respectively. During 1988, $3,212,000 of new loans were made, repayments totaled $6,106,000, and changes in the composition of the Group or their associations increased loans outstanding by $3,025,000.

Note E: Reserve for Loan Losses

Changes in the reserve for loan losses at December 31 are as follows (in thousands):

	1986	1987	1988
Balance, beginning of year	$ 16,590	$ 17,773	$17,203
Charge-offs	(16,246)	(11,814)	(7,646)
Recoveries	2,366	2,433	2,515
Net charge-offs	(13,880)	(9,381)	(5,131)
Provision for loan losses	15,063	8,811	6,418
Balance, end of year	$ 17,773	$ 17,203	$18,490

Note F: Premises and Equipment

Premises and equipment at December 31 consist of the following (in thousands):

	1987	1988
Land	$ 4,136	$ 4,127
Buildings and improvements	29,885	30,527
Furniture and equipment	18,888	19,748
	52,909	54,402
Less accumulated depreciation and amortization	24,900	27,244
	$28,009	$27,158

Note G: Long-Term Debt

Long-term debt (debt with original maturities of more than one year) at December 31 consists of the following (in thousands):

	1987	1988
Capital debentures with interest rate of 10% due in annual installments to 1994, noncollateralized	$2,000	$1,500
Industrial development bonds with interest rates of 6.0% due in semiannual installments to 1997, collateralized by certain bank premises with a book value of $2,569 in 1988	1,010	855
Mortgage notes with interest rates of 8% to 11% due in monthly installments to 1998, collateralized by certain bank premises with a book value of $2,062 in 1988	1,091	1,005
Housing development bonds with interest rates at 10.32% due in annual installments to 1990, collateralized by related home mortgages	815	569
Other	201	86
	$5,117	$4,015

Maturities of long-term debt outstanding at December 31, 1988, were as follows (in thousands):

1989	$ 555
1990	780
1991	496
1992	487
1993	503
Thereafter	1,194
	$4,015

The Company had an unused line of credit of $20 million with a bank at December 31, 1988. Borrowings under this line are noncollateralized and bear interest at .75% over the daily rate on federal funds. The line of credit expires on April 30, 1997.

Note H: Employee Benefit Plans

Pension Plan — The Company has a defined benefit pension plan covering substantially all of its employees. The benefits are based on age, years of service and the employee's highest average compensation during sixty (60) consecutive months of the last one hundred twenty (120) months of employment. The Company's funding policy is to contribute annually an amount approaching the maximum amount that can be deducted for federal income tax purposes.

Contributions are intended to provide for benefits attributed to service to date and for those expected to be earned in the future.

Note H: Employee Benefit Plans (continued)

The following table sets forth the plan's funded status and amount recognized in the Company's balance sheet at December 31 (in thousands):

	1986	1987	1988
Accumulated benefit obligation, including vested benefits of $1,602 in 1988	$ (450)	$ (928)	$(2,870)
Increase due to salary projections	(3,034)	(3,498)	(3,220)
Projected benefit obligation for service rendered to date	(3,484)	(4,426)	(6,090)
Plan assets (marketable securities) at fair value	704	1,576	4,435
Projected benefit obligation in excess of plan assets	(2,780)	(2,850)	(1,655)
Unrecognized actuarial loss	529	784	703
Prior service cost not yet recognized in net periodic pension cost	338	314	290
Unrecognized net asset being recognized over 14 years	(975)	(531)	(87)
Accrued pension cost included in other liabilities	$(2,888)	$(2,283)	$ (749)

Net periodic pension cost includes the following components (in thousands):

	1986	1987	1988
Service cost — benefits earned during the period	$ 377	$ 541	$ 588
Interest cost on projected benefit obligation	296	358	509
Actual (income) loss on plan assets	2	6	(297)
Net amortization and deferral	(496)	(518)	(373)
Net periodic pension cost	$ 179	$ 387	$ 427

The weighted average discount rate of 9.0% in 1986, 1987 and 1988 and rate of increase in future compensation levels of 6.0% for 1986, 1987 and 1988 were used in determining the actuarial present value of the projected benefit obligation. The expected long-term rate of return on assets was 10.5% for 1986 and 1987 and 9.0% for 1988.

Profit Sharing Plan — The profit sharing plan is a defined contribution plan, with contributions made by the participating employers. The profit sharing plan is noncontributory at the employee level, except for the employees' option to contribute under a 401(k) savings plan available as part of the profit sharing plan.

Contributions are calculated using a formula based primarily upon the participating employers' earnings in the current year. Contributions by the Company to the profit sharing plan were $917,000, $1,097,000 and $1,359,000 in 1986, 1987, and 1988, respectively.

Employee Stock Ownership Plan — Effective January 1, 1989, the Company adopted an employee stock ownership plan (the "ESOP"). The ESOP is a defined contribution plan covering substantially all employees, with contributions made exclusively by the Company on a discretionary year-by-year basis beginning in 1989.

Note I: Other Noninterest Expense

Other noninterest expense consists of the following (in thousands):

	1986	1987	1988
Printing, postage and office supplies	$ 3,097	$ 3,248	$ 3,388
Marketing	1,333	1,579	1,914
Data processing	4,514	2,928	1,460
Expenses related to other real estate owned	1,822	1,687	961
Other	8,909	7,989	8,498
	$19,675	$17,431	$16,221

Note J: Income Taxes

Effective January 1, 1987, the Company adopted Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes." This pronouncement requires that taxes be provided based upon the tax rates at which items of income and expense are expected to be settled in the Company's tax return. Previously, the deferred method was used. The Company has elected not to restate the prior years' financial statements. The cumulative effect at January 1, 1987, and the impact on 1987 net income of this change in accounting principle were not significant.

The components of the provision for income taxes are as follows (in thousands):

	1986	1987	1988
Current:			
Federal	$ (611)	$2,402	$ 4,009
State	1,355	1,292	1,835
Deferred	312	(793)	(1,544)
	$1,056	$2,901	$ 4,300

The components of the provision for deferred income taxes are as follows (in thousands):

	1986	1987	1988
Provision for loan losses	$ 149	$(467)	$(1,195)
Accrual to cash	(273)	(830)	(782)
Depreciation	351	170	157
Pension	132	227	227
Other	(47)	107	49
	$ 312	$(793)	$(1,544)

Note J: Income Taxes (continued)

A reconciliation between income tax expense and the amount computed by applying the statutory federal income tax rate is as follows (in thousands):

	1986	1987	1988
Tax at statutory rate	$5,561	$6,236	$6,519
Plus state income tax, net of federal tax benefits	675	665	985
	6,236	6,901	7,504
Less tax effect of:			
Interest on state and political subdivision securities	2,801	2,079	1,605
Other tax exempt interest	2,494	1,903	1,529
Amortization	384	347	300
Minority interest in earnings of subsidiaries	(499)	(329)	(323)
Other	—	—	93
	5,180	4,000	3,204
Income tax expense	$1,056	$2,901	$4,300

Income tax expense applicable to gains on investment securities for the years ended December 31, 1986, 1987 and 1988 was $4,793,000, $553,000, and $23,000, respectively.

Note K: Commitments and Contingencies

Standby Letters of Credit — Net outstanding standby letters of credit at December 31, 1987 and 1988 aggregated approximately $7,600,000 and $8,200,000, respectively.

Loan Commitments — As of December 31, 1987 and 1988, the Company had commitments outstanding to extend credit totaling $76,400,000 and $62,200,000, respectively.

Note L: Subsequent Event — Recapitalization

On February 8, 1989, the Company amended its Articles of Incorporation to authorize 12,000,000 shares of Class A Common Stock and 10,800,000 shares of Class B Common Stock. The 7,273 shares of common stock outstanding on that date and owned by Otto Bremer Foundation (the "Foundation") were exchanged for 1,200,000 shares of Class A Common Stock and 10,800,000 shares of Class B Common Stock. All references in the financial statements to the number of shares and per share amounts have been adjusted to reflect these changes in the capital structure of the Company.

The shares of Class A Common Stock have full rights to vote on all matters properly before the Company's shareholders, including the election of the Company's directors. The Class B Common Stock is non-voting except with respect to certain extraordinary corporate transactions, consisting of a vote on a proposed merger, consolidation, liquidation, or dissolution of the Company or a proposed sale of all or substantially all of its assets or a proposed amendment to the Company's Articles of Incorporation that would change the Company's capital structure or change the voting power of Class A Common Stock or Class B Common Stock. The holders of Class B Common Stock would have the right to vote on an equivalent per share basis with the holders of Class A Common Stock with respect to a vote on such transactions. In addition, each share of Class B Common Stock is convertible into one share of Class A Common Stock upon the occurence of the following events: (i) at the affirmative election of a third party or entity, upon the transfer of Class B Common Stock from the Foundation to any third party or entity, or (ii) at the affirmative election of the holder of Class B Common Stock, if cash dividends have not been paid on Class A Common Stock and Class B Common Stock in any year (beginning in 1989) in

Note L: Subsequent Event — Recapitalization (continued)

an amount equal to at least 5% of the Company's consolidated net book value as of the last day of the immediately preceding fiscal year (beginning with 1988). The Company has reserved 10,800,000 shares of Class A Common Stock in the event of the conversion of the Class B Common Stock.

The sale or transfer of shares of Class A Common Stock are restricted by the Company's Articles of Incorporation, which provide the Company, the Foundation or their transferees or designated assignees an option to purchase the shares at a formula price under certain circumstances. The holders of Class A Common Stock have the right to sell all or part of their shares to the Foundation, and the Foundation has the right to purchase those shares, upon the sale of all or substantially all of the shares of Class B Common Stock held by the Foundation. Holders of Class A Common Stock also have the right to require the Company to purchase their shares, and the Company has the right to purchase those shares at a formula price, if the holder is an employee of the Company, upon the employee's death, permanent disability or retirement or if the shares were distributed to the holder from the Company's Employee Stock Ownership Plan. In addition, the Company may grant to individual non-employee directors of the Subsidiary Banks who purchase shares of Class A Common Stock a put option that would allow the director to require the Company or its designated assignee to purchase all shares of Class A Common Stock then owned by such director when he or she ceases to be a director of the Subsidiary Bank. In that case, the Company would also be granted by the non-employee director a call option allowing the Company or its designated assignee to purchase all of the director's shares when the director ceases to be a director of the Subsidiary Bank.

Note M: Restatement for Correction of an Error

The financial statements for 1987 have been properly restated to reflect a supplemental retirement agreement that should have been reflected as a liability at December 31, 1987. The restatement, adjusted for an income tax benefit of $292,000, decreased net income and shareholder's equity by $343,000, or $.03 per share.

BREMER FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

Note N: Bremer Financial Corporation (Parent Company Only) Condensed Statements

Condensed Balance Sheets
December 31, 1987 and 1988
(Dollar amounts in thousands)

	1987	1988
Assets		
Cash and cash equivalents	$ 798	$ 679
Investment in and advances to subsidiaries (including $120,890 and $127,211 in 1987 and 1988, respectively, with Subsidiary Banks)	125,408	131,872
Other assets	965	822
Total assets	$127,171	$133,373
Liabilities and Shareholder's Equity		
Notes payable	$ 5,158	$ 75
Accrued expenses and other liabilities	654	965
Total liabilities	5,812	1,040
Shareholder's equity		
Common stock:		
Class A, no par, 12,000,000 shares authorized; 1,200,000 shares issued and outstanding	285	285
Class B, no par, 10,800,000 shares authorized, issued and outstanding	2,562	2,562
Retained earnings	118,512	129,486
Total shareholder's equity	121,359	132,333
Total liabilities and shareholder's equity	$127,171	$133,373

Condensed Statements of Income
Years Ended December 31, 1986, 1987 and 1988
(In thousands)

	1986	1987	1988
Income			
Dividends from subsidiary banks	$ 8,161	$ 9,850	$ 9,691
Interest income subsidiaries	172	107	82
Other income	2	—	—
Total income	8,335	9,957	9,773
Expenses			
Salaries and employee benefits	294	981	829
Interest on borrowed funds	754	626	259
Operating expense paid to subsidiaries	203	391	436
Other operating expenses	46	85	123
Total expenses	1,297	2,083	1,647
Income before income tax benefit	7,038	7,874	8,126
Income tax benefit	563	905	630
Income of parent company only	7,601	8,779	8,756
Equity in undistributed earnings of subsidiaries	3,433	3,910	6,118
Net income	$11,034	$12,689	$14,874

BREMER FINANCIAL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (continued)

Note N: Bremer Financial Corporation (Parent Company Only) Condensed Statements (continued)

Statements of Cash Flows
Years Ended December 31, 1986, 1987 and 1988
(In thousands)

	1986	1987	1988
Cash flows from operating activities:			
Net income	$11,034	$12,689	$14,874
Adjustments to reconcile net income to net cash provided by operations:			
Equity in undistributed earnings of subsidiaries	(3,433)	(3,910)	(6,118)
Other, net	(100)	199	454
Net cash provided by operating activities	7,501	8,978	9,210
Cash flows from investing activities:			
Investment in and advances to subsidiaries, net	(5,532)	(953)	(346)
Cash flows from financing activities:			
Notes payable, net	1,420	(4,782)	(5,083)
Dividends paid	(3,000)	(3,800)	(3,900)
Net cash used by financing activities	(1,580)	(8,582)	(8,983)
Increase (decrease) in cash and cash equivalents	389	(557)	(119)
Cash and cash equivalents			
Beginning of year	966	1,355	798
End of year	$ 1,355	$ 798	$ 679
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 754	$ 626	$ 259

Certain restrictions exist regarding the extent to which banks may transfer funds to the Company in the form of dividends. Federal law prevents the Company and its nonbank subsidiaries from borrowing from the Subsidiary Banks unless the loans are secured by specified U.S. obligations. Further, the secured loans that may be made by Subsidiary Banks are generally limited in amount to 10% of the Subsidiary Bank's equity if made to the Company or any individual affiliate and 20% of the Subsidiary Bank's equity if made to all affiliates and the Company in the aggregate. At December 31, 1986, 1987 and 1988, no Subsidiary Banks had extended credit to the Company.

Payment of dividends to the Company by its Subsidiary Banks is subject to various limitations by bank regulators. As of December 31, 1988, $38,200,000 of retained earnings of the Subsidiary Banks was available for distribution to the Company as dividends subject to these limitations. Approximately $11,000,000 was available for distribution without obtaining the prior approval of the appropriate bank regulator.

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No dealer, salesman, or any other person has been authorized to give any information or to make any representations other than those contained in this Prospectus in connection with the offering herein contained and, if given or made, such information or representations must not be relied upon as having been authorized by the Company or the Foundation. This Prospectus does not constitute an offer to sell, or a solicitation of an offer to buy, the securities offered hereby in any jurisdiction to any person to whom it is unlawful to make an offer or solicitation. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create an implication that there has been no change in the affairs of the Company since the date hereof.

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Until July 19, 1989 (90 days after the commencement of this offering), all dealers effecting transactions in the registered securities, whether or not participating in this distribution, may be required to deliver a Prospectus. This delivery requirement is in addition to the obligation of dealers to deliver a Prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

BREMER FINANCIAL CORPORATION

BREMER®

PROSPECTUS

April 20, 1989