

# MINNEAPOLIS ST. PAUL BUSINESS JOURNAL

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## Alleged check-kiting incident cost Pinehurst Bank \$2M

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Pinehurst Bank, one of the most under-capitalized banks in the Twin Cities, lost \$2 million last year due to one customer's alleged check-kiting activity and related loans designed to help the customer, according to one of the bank's 75 shareholders.

That loss represents 38 percent of the bank's total 2009 loss of \$5.2 million.

The shareholder, who declined to be named in this article due to confidentiality requirements, said regulators required the bank to set aside \$2 million in provisions related to the incident, which was discovered in January during the course of St. Paul-based Pinehurst's annual external audit.

Soon after the discovery, the bank's board removed the bank's president and CEO, John Markert, the shareholder said. The board then hired Thomas Palmer as interim CEO; Palmer was the top executive at St. Stephen State Bank in its final months before regulators closed it in January.



Calo

The bank amended its year-end report to the Federal Deposit Insurance Corp. to reflect the additional loss, according to the shareholder.

Palmer and Markert couldn't be reached for comment for this article.

Pinehurst's chief regulators, the Minnesota Department of Commerce and the U.S. Federal Deposit Insurance Corp., said they don't disclose whether they're conducting investigations.

The shareholder, though, said the FDIC told the bank to refer the matter to law enforcement, which it has. FBI agent E.K. Wilson at the bureau's Minneapolis office declined to say whether there is an investigation, citing agency policy. Speaking generally, Wilson said the FBI would either investigate check kiting allegations or refer



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**Pinehurst Bank, based in St. Paul, lost \$5.2 million in 2009, and is under FDIC restrictions.**

them to state law enforcement, depending on the amount of money involved and other factors.

The alleged check kiting took place in early 2009 and involved a "significant customer," according to the shareholder.

Check kiting involves writing a check from one bank and depositing it into another when the first account doesn't have enough money to cover the check. The second bank initially assumes there are adequate funds and honors the check.



Lawler

The person engaged in the kiting is usually betting that he or she can get money into the first account in a short period of time. But if that doesn't happen, the trouble can quickly balloon as a larger bad check from the second institution is used to cover the amount in the first account, and so forth.

In Pinehurst's case, the customer in question made a series of transactions that

### PINEHURST BANK

Interim CEO: **Thomas Palmer**

Location: **St. Paul**

Assets: **\$61.2 million**

Employees: **About 15**

Founded: **2004**

Web: **[pinehurstbank.com](http://pinehurstbank.com)**

eventually resulted in nearly \$2 million in overdrafts, according to the bank shareholder. Certain bank officers honored those overdrafts, then issued a series of loans to the customer's associates in a way that avoided triggering legal and loan requirements and board scrutiny, the shareholder said.

The loss of \$2 million over the incident helped stick Pinehurst in a difficult situation. The bank, which has \$61.2 million in assets, lost another \$1.2 million in the first quarter of this year. It had a risk-based capital ratio of negative 0.88 percent as of March 31, which means it has no more capital on hand to cover loan losses.

The FDIC recently issued a consent order

# **PINEHURST:** Alleged check-kiting incident cost community bank \$2 million

against the bank that included the requirement that Pinehurst “correct all violations of laws and regulations cited by the FDIC in the report of examination.”

Check kiting can be prosecuted as a felony under federal bank fraud laws, and there have been more prosecutions since laws were toughened 20 years ago, said Robert Calo, a former federal prosecutor in Los Angeles and Philadelphia who is now a shareholder at law firm Lane Powell in Portland, Ore.

Calo said bank officials are typically supposed to file a suspicious transactions report with the U.S. Treasury Department when they suspect check kiting, and it is in their interest to do so because bank insurers generally cover fraud losses.

Bankers who fail to notify authorities of suspicious transactions and whose actions assist a check kiter could get into possible trouble for “aiding and abetting,” Calo said.

Bank officials could have legitimate

reasons or a defense for not alerting law enforcement, said William Lawler III, a former Assistant U.S. Attorney who is now a partner at Vinson & Elkins’ Washington, D.C., office. He said bank officers have other obligations, such as the need to prevent large financial losses. “They’re supposed to exercise their judgment to make sure the institution is not harmed, within the bounds of the law.”

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