

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

_____)	
In the Matter of)	
)	
FIRST STATE BANK)	ORDER TO CEASE AND DESIST
DANVILLE, VIRGINIA)	
)	FDIC-07-051b
)	
(Insured State Nonmember Bank))	
_____)	

First State Bank, Danville, Virginia ("Bank"), having been advised of its right to a Notice of Charges and of Hearing detailing the unsafe or unsound banking practices and violations of law and regulations alleged to have been committed by the Bank and of its right to a hearing on the alleged charges under section 8(b)(1) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. § 1818(b)(1), and having waived those rights, entered into a STIPULATION AND CONSENT TO THE ISSUANCE OF AN ORDER TO CEASE AND DESIST ("Consent Agreement") with counsel for the Federal Deposit Insurance Corporation ("FDIC") and with a representative of the Virginia Bureau of Financial Institutions ("Bureau"), dated March 30, 2007, whereby solely for the purpose of this proceeding and without admitting or denying any of the charges of unsafe or unsound banking practices and violations of laws and regulations, the Bank has consented to the issuance of an ORDER TO CEASE AND DESIST ("Order") by the FDIC and the Bureau. The Bureau may issue an order to cease and desist pursuant to Va. Code Ann. Section 6.1-92 (1999).

The FDIC and the Bureau considered the matter and determined there is reason to believe the Bank had engaged in unsafe or unsound banking practices and committed violations of law

and regulations. The FDIC and the Bureau, therefore, accepted the Consent Agreement and issued the following:

ORDER TO CEASE AND DESIST

It is HEREBY ORDERED, that the Bank, its institution-affiliated parties, as that term is defined in section 3(u) of the Act, 12 U.S.C. § 1813(u), and its successors and assigns cease and desist from the following unsafe and unsound banking practices and violations of law and regulations:

- (a) operating with inadequate management;
- (b) operating with a board of directors that has failed to provide adequate supervision over and direction to the active management of the Bank;
- (c) operating with inadequate equity capital and reserves in relation to the volume and quality of assets held by the Bank;
- (d) operating the Bank with a large volume of poor quality loans;
- (e) following hazardous lending and lax collection practices;
- (f) operating in such a manner as to produce net operating losses; and
- (g) violating law and applicable regulations.

IT IS HEREBY ORDERED, that the Bank, its institution-affiliated parties, and its successors and assigns take affirmative action as follows:

MANAGEMENT

. The Bank shall have and retain qualified management.

(a) Each member of management shall have qualifications and experience commensurate with his or her duties and responsibilities at the Bank including the following:

(i) a chief executive officer responsible for supervision of the lending function and with oversight responsibility for all other areas of bank operations. This individual must have the proven ability in managing a bank of comparable size and in effectively implementing lending, investment and operating policies in accordance with sound banking practices; and

(ii) a senior lending officer with significant appropriate lending, collection, and loan supervision experience, and proven success in upgrading a low quality loan portfolio.

(b) The qualifications of management shall be assessed on each person's ability to:

(i) comply with the requirements of this Order;

(ii) operate the Bank in a safe and sound manner;

(iii) comply with applicable laws and regulations; and

(iv) restore asset quality, capital adequacy, earnings, and management effectiveness.

(c) During the life of this Order, the Bank shall notify the Regional Director of the FDIC's Atlanta Regional Office ("Regional Director") and the Commissioner of Financial Institutions ("Commissioner") (collectively, "Supervisory Authorities") in writing when it proposes to add any individual to the Bank's board of directors ("Board") or employ any individual as a senior executive officer, as that term is defined in Part 303 of the FDIC Rules and Regulations, 12 C.F.R. § 303.12. The notification must be received at least 30 days before such addition or employment is intended to become effective and should include a description of the background and experience of the individual or individuals to be added or employed. When the

Supervisory Authorities have issued their nonobjections to the proposed changes or appointments, the proposed individual(s) may begin serving in their designated capacities.

(d) The Bank may not add any individual to its Board or employ any individual as a senior executive officer if the Regional Director issues a notice of disapproval pursuant to section 32 of the Act, 12 U.S.C. § 1831i.

(e) To facilitate having and retaining qualified management, the Board shall in no more than 60 days from the effective date of this Order develop a written analysis and assessment of the Bank's management and staffing needs ("management plan"), including, at a minimum

- (i) identification of both the type and number of officer positions needed to manage and supervise properly the affairs of the Bank;
- (ii) identification and establishment of such Bank committees as are needed to provide guidance and oversight to active management;
- (iii) evaluation of each Bank officer to determine whether these individuals possess the ability, experience and other qualifications required to perform present and anticipated duties, including adherence to the Bank's established policies and practices, and maintenance of the Bank in a safe and sound condition; and
- (iv) a plan of action to recruit and hire any additional or replacement personnel with the requisite ability, experience and other qualifications, that the Board determines are necessary to fill the Bank officer positions consistent with the Board's analysis, evaluation and assessment as provided in paragraphs 1(e)(i) and 1(e)(iii) of this Order.

(f) The written management plan and any subsequent modification thereto shall be submitted to the Supervisory Authorities for review and comment. No more than 60

days from the receipt of any comment(s) from the Supervisory Authorities, and after consideration of such comment(s), the Board shall approve the written management plan and/or any subsequent modification.

BOARD OF DIRECTORS

2. (a) Immediately upon the effective date of this Order, the Board shall increase its participation in the affairs of the Bank, assuming full responsibility for the approval of sound policies and objectives and for the supervision of all of the Bank's activities, consistent with the role and expertise commonly expected for directors of banks of comparable size. This participation shall include meetings to be held no less frequently than monthly at which, at a minimum, the following areas shall be reviewed and approved: reports of income and expenses; new, overdue, renewal, insider, charged-off, and recovered loans; investment activity; operating policies; and individual committee actions. Board minutes shall document these reviews and approvals, including the names of any dissenting directors.

(b) Within 60 days from the effective date of this Order, the Board shall develop, adopt, and submit to the Supervisory Authorities for review, an educational program for each member of the Board. The educational program shall include, at a minimum:

(i) specific training in the areas of lending, operations, and compliance with laws, rules and regulations applicable to banks chartered in the Commonwealth of Virginia; and

(ii) specific training in the duties and responsibilities of the Board in connection with the safe and sound operation of the Bank.

(d) Upon adoption of the educational program, it shall be submitted to the Supervisory Authorities for review and comment. The Board shall document the training

activities in the minutes of the next Board meeting following completion of any training. The Board's actions as required by this paragraph shall be satisfactory to the Supervisory Authorities as determined at subsequent examinations.

SENIOR LENDING OFFICER

3. (a) Within 90 days of the effective date of this Order, the Bank shall hire or appoint a qualified person to serve as the Bank's senior lending officer. The senior lending officer shall have training in the underwriting and collection of assets and demonstrated loan workout experience in a financial institution. The senior lending officer's qualifications shall be assessed on his/her ability to: comply with the applicable requirements of this Order, applicable laws and regulations, and the Bank's written loan and collection policies.

(b) The senior lending officer shall be responsible for overseeing the collection of delinquent loans and disposal of assets taken for debts previously contracted, with Board approval when required. The senior lending officer shall report at least monthly and directly to the Board. The written reports shall:

(i) identify all outstanding problem and delinquent loans and assets taken for debts previously contracted;

(ii) provide the status of collection efforts during the preceding month and the prospects for full collection and/or the strengthening of the quality of all problem and delinquent loan relationships that aggregate \$50,000 or more; and

(iii) provide the status of efforts during the preceding month to dispose of assets acquired for debts previously contracted.

(c) The Bank shall submit a copy of the most recent reports required by Paragraph 3(b) above to the Supervisory Authorities in accordance with the reporting requirements of Paragraph 12.

(d) The Bank shall provide prior notice to the Supervisory Authorities of the individual proposed as its senior lending officer. The notification should include a description of the background and experience of the individual to be hired or appointed. When the Supervisory Authorities have issued their nonobjection to the appointment, the proposed individual may begin serving as the Bank's senior lending officer.

CAPITAL

4. (a) Within 60 days from the effective date of this Order, the Bank shall develop and adopt a Capital Plan to meet the minimum Tier 1 capital and risk-based ratios set forth in Paragraph 4(b) and 4(c) of this Order. The Capital Plan shall be in a form and manner acceptable to the Supervisory Authorities as determined at subsequent examinations.

(b) During the life of this Order, the Bank shall maintain Tier 1 capital in such an amount as to equal or exceed 7.0 percent of the Bank's total assets ("Tier 1 capital ratio"). If, after the end of any calendar quarter, the Bank's Tier 1 capital ratio falls below 7.0 percent, the Bank shall implement its written plan for restoring the Bank's Tier 1 capital ratio to 7.0 percent within 90 days of the prior quarter end.

(c) During the life of this Order, the Bank shall maintain risk-based capital ratios such as will cause the bank to be "well capitalized" for purposes of section 38 of the Act, 12 U.S.C. § 1831o and Subpart B of Part 325 of the FDIC Rules and Regulations, 12 C. F. R. Part 325, Subpart B. The ratios shall be calculated pursuant to the FDIC Statement of Policy on Risk-Based Capital contained in Appendix A to Part 325 of the FDIC Rules and Regulations, 12

C.F.R. Part 325, Appendix A. If, after the end of any calendar quarter, the Bank's risk-based capital ratio falls below this requirement, the Bank shall implement its written plan for restoring the Bank's risk based capital ratio to the required minimum within 90 days of the prior quarter end.

(d) The level of Tier 1 capital to be maintained during the life of this Order pursuant to Subparagraph 4(b) shall be in addition to a fully funded allowance for loan and lease losses, the adequacy of which shall be satisfactory to the Supervisory Authorities as determined at subsequent examinations and/or visitations.

(e) Any increase in Tier 1 capital necessary to meet the requirements of Paragraph 4 of this Order may be accomplished by the following:

- (i) sale of common stock, subject to approval by the Bureau of Financial Institutions, or
- (ii) the sale of noncumulative perpetual preferred stock; or
- (iii) direct contribution of cash by the Board and/or shareholders of the Bank; or
- (iv) other means acceptable to the Supervisory Authorities; or
- (v) any combination of the above means.

Any increase in Tier 1 capital necessary to meet the requirements of Paragraph 4 of this Order may not be accomplished through a deduction from the Bank's allowance for loan and lease losses.

(e) For the purposes of this Order, the terms "Tier 1 capital" and "total assets" shall have, the meanings ascribed to them in Part 325 of the FDIC Rules and Regulations, 12 C.F.R. §§ 325.2(t) and 325.2(v).

(f) If all or part of any necessary increase in Tier 1 capital required by this Paragraph is accomplished by the sale of new securities, the Board shall forthwith take all necessary steps to adopt and implement a plan for the sale of such additional securities, including the voting of any shares owned or proxies held or controlled by them in favor of the plan. Should the implementation of the plan involve a public distribution of the Bank's securities (including a distribution limited only to the Bank's existing shareholders), the Bank shall prepare offering materials fully describing the securities being offered, including an accurate description of the financial condition of the Bank and the circumstances giving rise to the offering, and any other material disclosures necessary to comply with any applicable securities laws. Prior to the implementation of the plan and, in any event, not less than 15 days prior to the dissemination of such materials, the plan and any materials used in the sale of the securities shall be submitted to the FDIC, Accounting and Securities Disclosure Section, 550 17th Street, N.W., Washington, D.C. 20429, and the Bureau of Financial Institutions, P.O. Box 640, Richmond, Virginia 23218-0640. Any changes requested to be made in the plan or materials shall be made prior to their dissemination.

(g) In complying with the provisions of Paragraph 4 of this Order, the Bank shall provide to any subscriber and/or purchaser of the Bank's securities, a written notice of any planned or existing development or other changes which are materially different from the information reflected in any offering materials used in connection with the sale of Bank securities. The written notice required by this Paragraph shall be furnished within 10 days from the date such material development or change was planned or occurred, whichever is earlier, and shall be furnished to every subscriber and/or purchaser of the Bank's securities who received or was tendered the information contained in the Bank's original offering materials.

CHARGE-OFF

5. (a) As of the effective date of this Order, the Bank shall eliminate from its books, by charge-off or collection, all assets or portions of assets classified "Loss" as of the Report of Examination (ROE), that have not been previously collected or charged-off.

(b) As of the effective date of this Order, the Bank shall eliminate from its books, by collection, charge-off, or other proper entries, 50 percent of those assets classified "Doubtful" in the ROE that have not been previously collected or charged-off. If an asset classified "Doubtful" is a loan or a lease, the Bank may, in the alternative, increase its allowance for loan and lease losses by an amount equal to 50 percent of the loan or lease classified "Doubtful".

(c) Additionally, while this Order remains in effect, the Bank shall, within 30 days of the receipt of any official ROE from the FDIC or the Bureau, eliminate from its books, by collection, charge-off, or other proper entries, the remaining balance of any assets classified "Loss" and 50 percent of those classified "Doubtful" unless otherwise approved in writing by the Supervisory Authorities. If an asset classified "Doubtful" is a loan or lease, the Bank may, in the alternative, increase its allowance for loan and lease losses by an amount equal to 50 percent of the loan or lease classified "Doubtful."

(d) Within 180 days of the effective date of this Order, the Bank shall have reduced the assets classified "Substandard" and those assets classified "Doubtful" in the ROE that have not previously been charged off to not more than \$3,000,000.

(e) Within 360 days of the effective date of this Order, the Bank shall have reduced the assets classified "Substandard" and those assets classified "Doubtful" in the ROE that have not previously been charged off to not more than \$2,500,000.

(f) Within 540 days of the effective date of this Order, the Bank shall have reduced the assets classified "Substandard" and those assets classified "Doubtful" in the ROE that have not been previously been charged off to not more than \$1,500,000.

(g) The requirements of Subparagraphs 5(a), 5(b), 5(c), 5(d), 5(e), and 5(f) of this Order are not to be construed as standards for future operations and, in addition to the foregoing, the Bank shall eventually reduce the total of all adversely classified assets. Reduction of these assets through proceeds of other loans made by the Bank is not considered collection for the purpose of this paragraph. As used in Subparagraphs 5(d), 5(e), and 5(f) the word "reduce" means:

(i) to collect;

(ii) to charge-off; or

(iii) to sufficiently improve the quality of assets adversely classified to

warrant removing any adverse classification, as determined by the Supervisory Authorities.

NO ADDITIONAL CREDIT

6. (a) Beginning with the effective date of this Order, the Bank shall not extend, directly or indirectly, any additional credit to, or for the benefit of, any borrower who has a loan or other extension of credit from the Bank that has been classified, in whole or part, "Loss" or "Doubtful" and is uncollected. The requirements of this Paragraph shall not prohibit the Bank from renewing (after collection in cash of interest due from the borrowers) any credit already extended to any borrower.

(b) Additionally, during the life of this Order, the Bank shall not extend, directly or indirectly, any additional credit to, or for the benefit of, any borrower who has a loan or other extension of credit from the Bank that has been classified, in whole or in part, "Substandard" and is uncollected.

(c) Paragraph 6(b) shall not apply if the Bank's failure to extend further credit to a particular borrower would be detrimental to the best interests of the Bank. Prior to the extension of any additional credit pursuant to this Paragraph, either in the form of a renewal, extension, or further advance of funds, such additional credit shall be approved by a majority of the Board or a designated committee thereof, who shall certify in writing as follows:

- (i) why the failure of the Bank to extend such credit would be detrimental to the best interests of the Bank;
- (ii) that the Bank's position would be improved thereby; and
- (iii) how the Bank's position would be improved.

The signed certification shall be made a part of the minutes of the Board or its designated committee and a copy of the signed certification shall be retained in the borrower's credit file.

CASH DIVIDENDS

7. The Bank shall not pay cash dividends without the prior written consent of the Supervisory Authorities.

BUDGET

8. Within 60 days from the effective date of this Order, the Bank shall formulate and fully implement a written plan to improve earnings. This plan shall be forwarded to the Supervisory Authorities for review and comment and shall, at a minimum:

- (a) Identify goals and strategies for improving and sustaining the earnings of the Bank;

- (b) Identify the major areas in, and means by which, the Board will seek to improve the Bank's operating performance;
- (c) Require realistic and comprehensive budgets;
- (d) Describe the operating assumptions that form the basis for, and adequately support, major projected income and expense components; and
- (e) Require a budget review process to monitor the income and expenses of the Bank to compare the actual figures with budgetary projections;

Following the end of each calendar quarter, the Board shall evaluate the Bank's actual performance in relation to the plan required by this paragraph and shall record the results of the evaluation, and any actions taken by the Bank, in the minutes of the Board meeting when such an evaluation is undertaken.

VIOLATIONS

9. (a) Within 60 days from the effective date of this Order, the Bank shall eliminate and/or correct all violations of law, regulations and contravention of policy which are more fully set out on pages 25 and 26 in the October 23, 2006 ROE. In addition, the Bank shall take all necessary steps to ensure future compliance with all applicable laws and regulations.

INFORMATION TECHNOLOGY (IT)

10. (a) Within 90 days from the effective date of this Order, the Bank shall develop and fully implement an appropriate Customer Information Security Program Policy and Procedures to meet all the requirements of Part 364, Appendix B of the FDIC Rules and Regulations--Interagency Guidelines Establishing Information Security Standards. It shall at a minimum, address:

- (i) bankwide risk assessment of all information assets;

- (ii) appropriate controls to properly safeguard information assets;
- (iii) periodic independent testing of controls;
- (iv) employee training to ensure controls are properly implemented,

including the appointments of an effective Information Security Officer and a knowledgeable Network Manager;

- (v) effective vendor management;
- (vi) incident response program; and
- (vii) at least annual Board reporting.

(b) Within 120 days, from the effective date of this Order, the Bank shall establish a comprehensive IT Audit program based on the bankwide risk assessment 10(a)(i), and established in accordance with the guidance outlined in the Federal Financial Institution Examination Council (FFIEC) Information Technology Examination Handbook “Audit Booklet”. It shall, at a minimum, address:

- (i) An audit schedule commensurate to the risks identified;
- (ii) Measures to ensure timely corrections of noted deficiencies;
- (iv) Adequate audit scope and review, either through a sufficiently trained IT internal auditor or third parties;
- (viii) Establishment of adequate Audit Manuals; and
- (ix) Audit Committee oversight and Board reporting.

(c) Within 120 days from the effective date of this Order, the Bank shall develop a bank-wide business continuity plan in accordance with the FFIEC guidance outlined in the IT Examination Handbook “Business Continuity Planning Booklet”.

(d) Within 90 days from the effective date of this Order, the Bank shall

correct all the IT deficiencies noted from the ROE as well as the August 7, 2006, NETBankAudit Risk Assessment and Vulnerability Assessment reports.

NOTICE TO SHAREHOLDERS

11. Following the effective date of this Order, the Bank shall send to its shareholders or otherwise furnish a description of this Order in conjunction with the Bank's next shareholder communication and also in conjunction with its notice or proxy statement preceding the Bank's next shareholder meeting. The description shall fully describe the ORDER in all material respects. The description and any accompanying communication, statement, or notice shall be sent to the FDIC, Registration and Disclosure Section, 550 17th Street, N.W., Washington, D.C. 20429, at least 15 days prior to dissemination to shareholders. Any changes requested to be made by the FDIC shall be made prior to dissemination of the description, communication, notice, or statement.

PROGRESS REPORTS

12. Within 45 days of the end of the first calendar quarter following the effective date of this Order, and within 45 days of the end of each calendar quarter thereafter, the Bank shall furnish written progress reports to the Supervisory Authorities detailing the form and manner of any actions taken to secure compliance with this Order and the results thereof. Such reports shall include a copy of the Bank's Report of Condition and the Bank's Report of Income. Such reports may be discontinued when the corrections required by this Order have been accomplished and the Supervisory Authorities have released the Bank in writing from making further reports.

This Order shall become effective 10 days from the date of its issuance.

The provisions of this Order shall remain effective and enforceable except to the extent that, and until such time as, any provisions of this Order shall have been modified, terminated, suspended, or set aside by the Supervisory Authorities.

Pursuant to delegated authority.

Dated at Atlanta, Georgia, this 10 day of April, 2007.

Mark S. Schmidt
Regional Director
Division of Supervision and Consumer
Protection
Atlanta Region
Federal Deposit Insurance Corporation

The Commissioner of Virginia having duly approved the foregoing Order, and the Bank, through its Board, agree that the issuance of the said Order by the Federal Deposit Insurance Corporation shall be binding as between the Bank and the Commissioner to the same degree and legal effect that such Order would be binding on the Bank if the Commissioner had issued a separate Order that included and incorporated all of the provisions of the foregoing Order pursuant to the provisions of Va. Code Ann. Title 6.1, (1999).

Dated this ____ day of ____, 2007.

E. Joseph Face, Jr.
Commissioner of Financial Institutions
Commonwealth of Virginia