

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

CALIFORNIA DEPARTMENT OF FINANCIAL INSTITUTIONS

SAN FRANCISCO, CALIFORNIA

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)
IN THE MATTER OF)
)

PACIFIC VALLEY BANK)
SALINAS, CALIFORNIA)

(INSURED STATE NONMEMBER BANK))
)
_____)

ORDER TO
CEASE AND DESIST

Docket FDIC-08-235b

Pacific Valley Bank, Salinas, California ("Bank"), having been advised of its right to a NOTICE OF CHARGES AND OF HEARING detailing the unsafe or unsound banking practices 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 Section 1912 of the California Financial Code, 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 counsel for the California Department of Financial Institutions ("CDFI"), dated November 5, 2008, whereby solely for the purpose of this proceeding and without admitting or denying the alleged charges of unsafe or unsound banking practices and violations of law and/or regulations, the Bank consented to the issuance of an ORDER TO CEASE AND DESIST ("ORDER") by the FDIC and the CDFI.

The FDIC and the CDFI considered the matter and determined that they had reason to believe that the Bank had engaged in unsafe or unsound banking practices. The FDIC and the CDFI, 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, as more fully set forth in the joint FDIC and CDFI Report of Examination (“ROE”) dated June 9, 2008:

- (a) operating with management whose policies and practices are detrimental to the Bank and jeopardize the safety of its deposits;
- (b) operating with a board of directors which has failed to provide adequate supervision over and direction to the management of the Bank;
- (c) operating with inadequate capital in relation to the kind and quality of assets held by the Bank;
- (d) operating with an inadequate loan valuation reserve;
- (e) operating with a large volume of poor quality loans;
- (f) engaging in unsatisfactory lending and collection practices;
- (g) operating in such a manner as to produce operating losses;
- (h) operating with inadequate provisions for liquidity; and
- (i) operating with inadequate internal routine and control policies.

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

1. The Bank shall have and retain qualified management. Each member of management shall have qualifications and experience commensurate with his or her duties and responsibilities at the Bank. Such management shall include a president/chief executive officer, a chief financial officer, and a senior lending officer (collectively referred to as the “executive officers”), qualified to restore the Bank to a sound condition, operate the Bank in a safe and sound manner, and comply with the provisions of this ORDER. Without limiting the generality of the foregoing, the Regional Director of the FDIC’s San Francisco Regional Officer (“Regional Director”) and the Commissioner of the CDFI (“Commissioner”) reserve the right to determine whether present members of management and the Board of the Bank will be deemed acceptable. Each member of management shall be provided appropriate written authority from the Bank’s Board to implement the provisions of this ORDER.

(a) The qualifications of management shall be assessed on its 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 all aspects of the Bank to a safe and sound condition,

including asset quality, capital adequacy, earnings, management effectiveness, liquidity, and sensitivity to market risk.

(b) During the life of this ORDER, the Bank shall notify the Regional Director and the Commissioner in writing when it proposes to add any individual to the Bank’s Board or employ any individual as an executive officer. 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. The Bank shall not add any individual to the Bank's Board or employ any individual as an executive officer of the Bank if, in response to the notification as required by this paragraph, the Regional Director and Commissioner notify the Bank of their disapproval.

(c) Within 60 days from the effective date of this ORDER, the Bank shall develop, adopt, and implement a written ethics policy ("Ethics Policy") and procedure ("Ethics Program"), acceptable to the Regional Director and the Commissioner as determined at subsequent examinations.

2. Within 60 days from the effective date of this ORDER, the Bank's 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; concentrations of credit; funds management; investment activity; sensitivity to market risk; operating policies; and individual committee actions. The Bank's Board minutes shall document these reviews and approvals, including the names of any dissenting directors.

3. Within 60 days of the ORDER, the Bank's Board shall review the appropriateness of the membership of the Audit Committee and ensure complete minutes are maintained.

Further, the Audit Committee shall improve oversight over the audit function as fully detailed on pages 17-18 of the ROE.

4. (a) Within 90 days from the effective date of this ORDER, and continuing through the life of this ORDER, the Bank shall maintain a level of Tier 1 Capital to Average Assets at no lower than 9 percent.

(b) Within 90 days from the effective date of this ORDER, the Bank shall develop and adopt a plan to meet and maintain a level of Total Risk-Based Capital to Risk-Weighted Assets at no lower than 10 percent. The Plan shall be in a form and manner acceptable to the Regional Director and the commissioner as determined at subsequent examinations.

(c) The level of Tier 1 capital to be maintained during the life of this ORDER pursuant to Subparagraph 4(a) shall be in addition to a fully funded allowance for loan and lease losses, the adequacy of which shall be satisfactory to the Regional Director and the Commissioner as determined at subsequent examinations.

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

- (i) the sale of common stock; or
- (ii) the sale of noncumulative perpetual preferred stock; or
- (iii) the direct contribution of cash by the Bank's Board and/or shareholders of the Bank; or
- (iv) the direct contribution of cash by the Bank's Board, shareholders, and/or parent holding company; or
- (v) any other means acceptable to the Regional Director and the Commissioner; or

(vi) 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) If all or part of the increase in Tier 1 capital required by Paragraph 4 of this ORDER is accomplished by the sale of new securities, the Bank's 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 the Federal securities laws and California Financial Code Section 690 *et. seq.* 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, Registration and Disclosure Unit, Washington, D.C. 20429, for review, and the CDFI for review. Any changes requested to be made in the plan or materials by the FDIC or the CDFI shall be made prior to their dissemination. If the increase in Tier 1 capital is provided by the sale of noncumulative perpetual preferred stock, then all terms and conditions of the issue, including but not limited to those terms and conditions relative to interest rate and convertibility factor, shall be presented to the Regional Director and the Commissioner for prior approval.

(f) 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.

(g) 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's Rules and Regulations, 12 C.F.R. §§ 325.2(v) and 325.2(x).

5. (a) Within 30 days from the effective date of this ORDER, the Bank shall increase its allowance for loan and lease losses by \$345,000.

(b) Additionally, within 60 days from the effective date of this ORDER, the Bank's Board shall develop or revise, adopt and implement a comprehensive policy for determining the appropriateness of the allowance for loan and lease losses. For the purpose of this determination, the appropriateness of the reserve shall be determined after the charge-off of all loans or other items classified "Loss." The policy shall provide for a review of the allowance at least once each calendar quarter. Said review should be completed at least 10 days prior to the end of each quarter, in order that the findings of the Bank's Board with respect to the loan and lease loss allowance may be properly reported in the quarterly Reports of Condition and Income. The review should focus on the results of the Bank's internal loan review, loan loss experience, trends of delinquent and non-accrual loans, an estimate of potential loss exposure of significant

credits, concentrations of credit, and present and prospective economic conditions. A deficiency in the allowance shall be remedied in the calendar quarter it is discovered, prior to submitting the Report of Condition, by a charge to current operating earnings. The minutes of the Bank's Board meeting at which such review is undertaken shall indicate the results of the review. Upon completion of the review, the Bank shall increase and maintain its allowance for loan and lease losses consistent with the allowance for loan and lease loss policy established. Such policy and its implementation shall be satisfactory to the Regional Director and the Commissioner as determined at subsequent examinations.

6. (a) Within 30 days from the effective date of this ORDER, the Bank shall eliminate from its books, by charge-off or collection, all assets classified "Loss" in the ROE that have not been previously collected or charged off. Elimination of these assets through proceeds of other loans made by the Bank is not considered collection for the purpose of this paragraph.

(b) Within 180 days from the effective date of this ORDER, the Bank shall have reduced the assets classified "Substandard" in the ROE that have not previously been charged off to not more than 20% of Tier 1 Capital plus the allowance for loan and lease losses.

(c) The requirements of Subparagraphs 6(a) and 6(b) 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 Subparagraph 6(b), 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 at subsequent examinations.

(d) Within 90 days from the effective date of this ORDER, the Bank shall adopt and implement a written plan for the reduction and collection of delinquent loans. The plan shall be acceptable to the Regional Director and the Commissioner as determined at subsequent examinations.

7. (a) Within 90 days from the effective date of this ORDER, the Bank shall revise, adopt, and implement written lending and collection policies to provide effective guidance and control over the Bank's lending function, which policies shall include specific guidelines for selection of credit risk, appraisal reviews, timely and appropriate grading of loans, boarding of loan data, adequate and accurate monitoring and reporting of asset concentrations, which are more fully set forth on pages 9-11 in the ROE. In addition, the Bank shall obtain adequate and current documentation for all loans in the Bank's loan portfolio. Such policies and their implementation shall be in a form and manner acceptable to the Regional Director and the Commissioner as determined at subsequent examinations.

(b) The initial revisions to the Bank's loan policy and practices, required by this paragraph, at a minimum, shall include the following:

(i) provisions, consistent with FDIC's instructions for the preparation of Reports of Condition and Income, under which the accrual of interest income is discontinued and previously accrued interest is reversed on delinquent loans;

(ii) provisions which prohibit the capitalization of interest or loan related expense unless the Bank's Board supports in writing and records in the minutes of the

corresponding Bank's Board meeting why an exception thereto is in the best interests of the Bank;

(iii) provisions which require complete loans documentation, realistic repayment terms, and current credit information adequate to support the outstanding indebtedness of the borrower. Such documentation shall include current financial information, profit and loss statements or copies of tax returns and cash flow projections;

(iv) provisions which incorporate limitations on the amount that can be loaned in relation to established collateral values;

(v) provisions which specify the circumstances and conditions under which real estate appraisals must be conducted by an independent third party;

(vi) provisions which establish standards for unsecured credit;

(vii) provisions which establish officer lending limits;

(viii) provisions that require extensions of credit to any of the Bank's executive officers, directors, or principal shareholders, or to any related interest of such persons, to be approved in advance by a majority of the entire Bank's Board in accordance with section 215.4(b) of Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. § 215.4(b);

(ix) provisions that directors first determine that the lending staff has the expertise necessary to properly supervise construction loans and that adequate procedures are in place to monitor any construction involved before funds are disbursed;

(x) provisions which prohibit concentrations of credit in excess of 25 percent of the Bank's total equity capital and reserves to any borrower and that borrower's related interests;

(xi) provisions which require the preparation of a loan "watch list" which shall include relevant information on all loans in excess of \$50,000, which are classified "Substandard" and "Doubtful" in the ROE, or by the FDIC or CDFI in subsequent reports of examination and all other loans in excess of \$10,000, which warrant individual review and consideration by the Bank's Board as determined by the loan committee or management. The loan "watch list" shall be presented to the Bank's Board for review at least monthly with such review noted in the minutes; and

(xii) the Bank's Board shall adopt procedures whereby officer compliance with the revised loan policy is monitored and responsibility for exceptions thereto assigned. The procedures adopted shall be reflected in minutes of a Bank's Board meeting at which all members are present and the vote of each is noted.

8. Within 90 days from the effective date of this ORDER, the Bank shall develop a written plan, approved by its Board and acceptable to the Regional Director and the Commissioner for meeting the guidelines established by FIL-104-2006 Commercial Real Estate Lending: Joint Guidance.

9. Within 90 days of the effective date of this ORDER, the Bank shall correct all Assets with Credit Data or Collateral Documentation Exceptions as more fully set forth in the ROE.

10. Within 90 days of the effective date of this ORDER, the Bank shall develop and submit to the Regional Director and Commissioner a written three-year strategic plan. Such plan shall include specific goals for the dollar volume of total loans, total investment securities, and total deposits as of December 31, 2009, and December 31, 2010. For each time frame, the plan

will also specify the anticipated average maturity and average yield on loans and securities; the average maturity and average cost of deposits; the level of earning assets as a percentage of total assets; and the ratio of net interest income to average earning assets. The plan shall be in a form and manner acceptable to the Regional Director and the Commissioner as determined at subsequent examinations.

11. Within 90 days from the effective date of this ORDER, the Bank shall formulate and implement a written profit plan and a comprehensive budget. The plan and budget required by this paragraph shall include formal goals and strategies, consistent with sound banking practices, to improve the Bank's net interest margin, increase interest income, reduce discretionary expenses, and improve and sustain earnings of the Bank. The profit plan shall include a description of the operating assumptions that form the basis for and adequately support, major projected income and expense components. Thereafter, the Bank shall formulate such a plan and budget by November 30, of each subsequent year. This plan and budget shall be forwarded to the Regional Director and the Commissioner for review and comment and shall address, at a minimum, the following:

(a) goals and strategies for improving and sustaining the earnings of the Bank, including:

(i) an identification of the major areas in, and means by which, the Bank's Board will seek to improve the Bank's operating performance;

(ii) realistic and comprehensive budgets for all categories of income and expense;

(iii) a budget review process to monitor the income and expenses of the Bank to compare actual figures with budgetary projections; and

(iv) a description of the operating assumptions that form the basis for, and adequately support, major projected income and expense components;

(b) coordination of the Bank's loan, investment, and operating policies, and budget and profit planning, with the funds management policy.

(c) Following the end of each calendar quarter, the Bank's Board shall evaluate the Bank's actual performance in relation to the plan and budget required by this ORDER and shall record the results of the evaluation, and any actions taken by the Bank, in the minutes of the Bank's Board meeting at which such evaluation is undertaken.

12. Within 60 days from the effective date of this ORDER, the Bank shall eliminate and/or correct all violations of law, as more fully set forth in the ROE. In addition, the Bank shall take all necessary steps to ensure future compliance with all applicable laws and regulations.

13. Within 90 days from the effective date of this ORDER, the Bank shall develop or revise, adopt, and implement a written liquidity and funds management policy. Such policy and its implementation shall address risk tolerance limits for volatile funding sources and the use of cash flow analysis. Such policy and its implementation shall be in a form and manner acceptable to the Regional Director and the Commissioner as determined at subsequent examinations.

14. Within 90 days from the effective date of this ORDER, the Bank shall develop policy and procedures to prudently control sensitivity to market risk. Further, an interest rate risk model shall be put in place that accurately and effectively measures the Bank's level of interest rate risk. Such policy and model shall be in a form acceptable to the Regional Director and the Commissioner as determined at subsequent examinations.

15. Within 60 days from the effective date of this ORDER, the Bank shall adopt and implement a policy for the operation of the Bank in such a manner as to provide adequate internal routine and control policies consistent with safe and sound banking practices. Such policy and its implementation shall be satisfactory to the Regional Director and the Commissioner as determined at subsequent examinations.

16. The Bank shall not pay cash dividends without the prior written consent of the Regional Director and the Commissioner.

17. The Board shall designate that the Audit Committee shall ensure that the Bank complies with the provisions of this ORDER. The committee shall report monthly to the full Board and a copy of the report and any discussion relating to the report or the ORDER shall be noted in the minutes of the Board meetings. This delegation to the Audit Committee shall not diminish the responsibility or liability of the entire Board to ensure compliance with the provisions of this ORDER.

18. Within 30 days of the end of the first quarter, following the effective date of this ORDER, and within 30 days of the end of each quarter thereafter, the Bank shall furnish written progress reports to the Regional Director and the Commissioner 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 Regional Director and the Commissioner have released the Bank in writing from making further reports.

19. Following the effective date of this ORDER, the Bank shall send to its shareholder(s) 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, Accounting and Securities Section, 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.

This ORDER will become effective upon its issuance by the FDIC and the CDFI. 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 FDIC and the CDFI.

Pursuant to delegated authority.

Dated at San Francisco, California, this 7th day of November, 2008.

J. George Doerr
Deputy Regional Director
Division of Supervision and Consumer Protection
San Francisco Region
Federal Deposit Insurance Corporation

William S. Haraf
Commissioner
California Department of
Financial Institutions