

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

OREGON DIVISION OF FINANCE AND CORPORATE SECURITIES

SALEM, OREGON

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| _____                          | ) |                     |
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| In the Matter of               | ) |                     |
|                                | ) |                     |
| SILVER FALLS BANK              | ) | ORDER TO            |
| SILVERTON, OREGON              | ) | CEASE AND DESIST    |
|                                | ) |                     |
| (INSURED STATE NONMEMBER BANK) | ) | Docket FDIC-08-272b |
|                                | ) |                     |
| _____                          | ) |                     |

Silver Falls Bank, Silverton, Oregon ("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 Oregon Revised Statutes, § 706.580(2), 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 Oregon Department of Consumer and Business Services acting through the Division of Finance and Corporate Securities ("DFCS"), dated November 24, 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 DFCS.

The FDIC and DFCS 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 DFCS, 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 DFCS Report of Examination (“ROE”) dated April 14, 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 active 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 in violation of the following: section 353.1 of the FDIC’s Rules and Regulations, 12 C.F.R. §§ 353.1; section 323.4(d) of the FDIC’s Rules and Regulations, 12 C.F.R. §323.4(d); and Part 364 of the FDIC’s Rules and Regulations, and its Appendix A, 12 C.F.R. Part 364; and section 706.580 of the Oregon Revised Statutes (ORS), all as more fully described in the ROE dated April 14, 2008;
- (i) operating with inadequate provisions for liquidity; and

- (j) operating with inadequate internal routine and controls 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.

- (a) Each member of management shall have qualifications and experience commensurate with his or her duties and responsibilities at the Bank. Management shall include a chief executive officer with proven ability in managing a bank of comparable size, and experience in upgrading a low quality loan portfolio, improving earnings, and other matters needing particular attention. Management shall also include a senior lending officer with significant appropriate lending, collection, and loan supervision experience and experience in upgrading a low quality loan portfolio. Each member of management shall be provided appropriate written authority from the Bank's Board to implement the provisions of this ORDER.

- (b) 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.

- (c) During the life of this ORDER, the Bank shall notify the Regional Director of the FDIC's San Francisco Regional Office ("Regional Director") and the Administrator of DFCS ("Administrator") in writing when it proposes to add any individual to the Bank's Board or employ any individual as a senior 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.

(d) Within 90 days after the effective date of this ORDER, the Bank's Board shall obtain an independent study of the management and personnel structure of the Bank to determine whether additional personnel are needed for the safe and profitable operation of the Bank. Such a study shall include, at a minimum, a review of the duties, responsibilities, qualifications, and remuneration of the Bank's officers. The Bank shall formulate and a plan to implement the recommendations of the study. The plan shall be acceptable to the Regional Director and the Administrator as determined at subsequent examinations.

(e) Within 10 days of the effective date of this ORDER, the Board shall approve a resolution that:

(i) Notes the termination of the employment of a certain employee that received incentive compensation based upon the volume of the new loans generated by the employee without consideration of the risk involved with each loan;

(ii) Affirms that no other employee is currently under a similar compensation arrangement; and

(iii) Agrees that all future compensation arrangements that involve incentives for lending officers will include an evaluation of the quality and risk associated with the loans generated by that officer.

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; investment activity; operating policies; and individual committee actions, and concentrations of credit. The Bank's Board minutes shall document these reviews and approvals, including the names of any dissenting directors.

3. (a) Within 120 days from the effective date of this ORDER, the Bank shall have and thereafter maintain Tier 1 capital in such an amount as to equal or exceed 10 percent of the Bank's total assets.

(b) Within 60 days from the effective date of this ORDER, the Bank shall develop and adopt a plan to meet and thereafter maintain the minimum risk-based capital requirements for a well-capitalized bank (Tier 1 risk-based capital ratio of 6 percent and total risk-based capital ratio of 10 percent) as described in the FDIC's Statement of Policy on Risk-Based Capital contained in Appendix A to Part 325 of the FDIC's Rules and Regulations, 12 C.F.R. Part 325, Appendix A. The Plan shall be in a form and manner acceptable to the Regional Director and the Administrator as determined at subsequent examinations.

(c) The level of Tier 1 capital to be maintained during the life of this ORDER pursuant to Subparagraph 3(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 Administrator as determined at subsequent examinations and/or visitations.

(d) Any increase in Tier 1 capital necessary to meet the requirements of Paragraph 3 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) any other means acceptable to the Regional Director and the Administrator; or
- (v) any combination of the above means.

Any increase in Tier 1 capital necessary to meet the requirements of Paragraph 3 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 3 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. 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 and to DFCS, for review. Any changes requested to be made in the plan or materials by the FDIC or DFCS 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 Administrator for prior approval.

(f) In complying with the provisions of Paragraph 3 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).

4. (a) Within 60 days from the effective date of this ORDER, the Bank shall increase its allowance for loan and lease losses by \$730,000.

(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 adequacy of the allowance for loan and lease losses. For the purpose of this determination, the adequacy 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 shall be completed after 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 Administrator as determined at subsequent examinations and/or visitations.

5. (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 dated April 14, 2008 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 dated April 14, 2008, that have not previously been charged off to not more than \$10,000,000.

(c) The requirements of Subparagraphs 5(a) and 5(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 Subparagraphs 5(b) and 5(c) 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 FDIC and DFCS.

(d) Within 90 days from the effective date of this ORDER, the Bank shall develop written asset disposition plans for each classified asset greater than \$50,000. The plans shall be reviewed and approved by the Bank's Board and acceptable to the Regional Director and the Administrator as determined at subsequent examinations.

(e) Within 60 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 Administrator as determined at subsequent examinations.

(f) As of the effective date of this ORDER, the Bank shall cease the origination of loans that are outside of the Bank's defined market area.

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 charged off or classified, in whole or in part, "Loss" and is uncollected. Subparagraph 6(a) of this ORDER shall not prohibit the Bank from renewing or extending the maturity of any credit in accordance with the Financial Accounting Standards Board Statement Number 15 ("FASB 15").

(b) Beginning with the effective date of this ORDER, the Bank shall not extend, directly or indirectly, any additional credit (new money) to, or for the benefit of, any borrower who has a loan or other extension of credit from the Bank in excess of \$50,000, that has been classified, in whole or part, "Substandard" at the April 14, 2008 Examination without the prior approval of a majority of the Bank's Board or the loan committee of the Bank.

(c) The loan committee or Bank's Board shall not approve any extension of credit, or additional credit to a borrower in Paragraphs (b) and (c) above without first collecting in cash all past due interest.

7. (a) Within 60 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 placing loans on a non-accrual basis. 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 Administrator as determined at subsequent examinations and/or visitations.

(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 loans 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 which prohibit the issuance of standby letters of credit unless the letters of credit are fully secured by readily marketable collateral and/or are supported by current and complete financial information;

(x) 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;

(xi) provisions which prohibit concentrations of credit in excess of the limitations contained in ORS 708A.290 to ORS 708A.375 or 25 percent of the Bank's total equity capital and reserves to any borrower and that borrower's related interests, whichever is lower;

(xii) 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 dated April 14, 2008, or by the FDIC or DFCS in

subsequent Reports of Examination and all other loans in excess of \$50,000, which warrant individual review and consideration by the Bank's Board as determined by the loan committee or active 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

(xiii) 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 60 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 Administrator for systematically reducing the amount of loans or other extensions of credit advanced, directly or indirectly, to or for the benefit of, any borrowers in the "Commercial Real Estate" Concentrations with particular emphasis on those borrowers in the "Construction and Land Development" area, as more fully set forth in the ROE dated April 14, 2008. Such plan shall address compliance with the provisions of the Financial Institution Letter entitled "Commercial Real Estate Lending: Joint Guidance" FIL-104-2006.

9. Within 120 days from the effective date of this ORDER, the Bank shall formulate and implement a written three-year strategic business plan. This plan shall address, at a minimum, the following:

(a) formal goals and strategies consistent with sound banking practices, to improve the Bank's net interest margin, increase interest income, reduce discretionary expenses and maintain the Bank's earnings.

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

(c) realistic and comprehensive budgets;

(d) a budget review process to monitor the actual income and expenses of the Bank in comparison with budgetary projections;

(e) a description of the operating assumptions that form the basis for, and adequately support, major projected income and expense components. The Bank's loan, investment and operating policies and budget and profit plans must be revised to insure consistency with the Bank's strategic plan. The Bank shall update and review the strategic business plan by December 31<sup>st</sup> of each year;

(f) the strategic business plan required by paragraph 9 of this ORDER, upon completion, shall be submitted to the Regional Director and Administrator for their review and opportunity for comment; and

(g) following the end of each calendar quarter, the Bank's Board shall evaluate the Bank's actual performance in relation to the strategic business plan required by paragraph 9 of 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.

10. 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 dated April 14, 2008. In addition, the Bank shall take all necessary steps to ensure future compliance with all applicable laws and regulations.

11. Within 60 days from the effective date of this ORDER, the Bank shall develop or revise, adopt, and implement a written liquidity and funds management policy that adequately addresses liquidity needs and appropriately reduces the reliance on non-core funding sources.

Such policy and its implementation shall be in a form and manner acceptable to the Regional Director and the Administrator as determined at subsequent examinations and/or visitations.

12. 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 Administrator as determined at subsequent examinations and/or visitations.

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

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

15. 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 Administrator and to the FDIC's, 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 or the Administrator 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 DFCS. 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 DFCS.

Pursuant to delegated authority.

Dated at San Francisco, California, this 25<sup>th</sup> day of November, 2008.

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

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David C. Tatman  
Administrator  
Oregon Division of Finance and Corporate Securities