

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

WASHINGTON DEPARTMENT OF FINANCIAL INSTITUTIONS

OLYMPIA, WASHINGTON

_____)	
In the Matter of)	
NORTH COUNTY BANK)	ORDER TO CEASE AND DESIST
ARLINGTON, WASHINGTON)	FDIC-09-362b
(INSURED STATE NONMEMBER BANK))	
_____)	

North County Bank, Arlington, Washington (“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/or 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 Revised Code of Washington, Anno. § 30.04.450, 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 Washington Department of Financial Institutions (“WDFI”), dated August 14, 2009, 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 WDFI.

The FDIC and the WDFI considered the matter and determined that they had reason to believe that the Bank had engaged in unsafe or unsound banking practices and violations of law

and/or regulations. The FDIC and the WDFI, 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/or regulations, as more fully set forth in the Joint FDIC and WDFI Report of Examination dated February 17, 2009 (“ROE”):

- (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 section 323.3(a) of the FDIC Rules and Regulations, 12 C.F.R. § 323.3(a), as more fully set forth in the Joint ROE;
- (i) operating with inadequate provisions for liquidity; and
- (j) operating with excessive commercial real estate and acquisition, development, or construction concentrations.

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 of Directors ("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 Director of the WDFI, Division of Banks ("Director") in writing when it proposes to add any individual to the Board or employ any individual as a senior executive officer, as that term is defined in Part 303 of the FDIC's Rules and Regulations, 12 C.F.R. § 303.102. The notification shall include a

description of the background and experience of the individual or individuals to be added or employed and must be received at least 30 days before such addition or employment is intended to become effective. The Regional Director and Director shall have the power under the authority of this ORDER to disapprove the appointment of the proposed officer or director.

(d) The requirement to submit information and the prior disapproval provisions of this paragraph are based upon the authority of 12 U.S.C. § 1818(b) and does not require the Regional Director to complete his review and act on any such information or authority within 90 days.

(e) Within 90 days from the effective date of this ORDER, the 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 a plan to implement the recommendations of the study. The plan shall be acceptable to the Regional Director and the Director as determined at subsequent examinations and/or visitations.

2. (a) Within 180 days from the effective date of this ORDER, the Bank shall increase Tier 1 capital in such an amount as to equal or exceed 10 percent of the Bank's total assets and shall thereafter maintain Tier 1 capital at such level.

(b) Within 180 days from the effective date of this ORDER, the Bank shall develop and adopt a plan to meet and thereafter maintain the minimum of 12.5 percent risk-based capital, calculated in accordance with 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 Director as determined at subsequent examinations and/or visitations.

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

(d) Any increase in Tier 1 capital necessary to meet the requirements of this ORDER may be accomplished by the sale of common stock; the sale of noncumulative perpetual preferred stock; the direct contribution of cash by the Bank’s Board, shareholders, and/or parent holding company; any other means acceptable to the Regional Director and the Director; or any combination of the above means. Any increase in Tier 1 capital necessary to meet the requirements 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’s Rules and Regulations, 12 C.F.R. §§ 325.2(v) and 325.2(x).

3. (a) Within 45 days from the effective date of this ORDER, the Board shall review the appropriateness of the Bank’s ALLL and establish a comprehensive policy for determining the appropriate level of the ALLL, including documenting its analysis according to the standards set forth in the July 25, 2001, Interagency Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Associations. For the purpose of this determination, an appropriate ALLL shall be determined after the charge-off of all loans or other items classified “Loss.” The policy shall provide for a review of the ALLL at least once each calendar quarter. Said review should be completed in order that the findings of the Board with respect to the ALLL are properly reported in the quarterly Reports of Condition and Income. The review should focus on the accounting standards set forth in Statements of

Financial Accounting Standards Board (“FASB”) Number 15 and 114, results of the Bank's internal loan review, loan and lease 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 ALLL 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 Board meeting at which such review is undertaken shall indicate the results of the review. The Bank’s policy for determining the adequacy of the ALLL and its implementation shall be satisfactory to the Regional Director and the Director as determined at subsequent examinations and/or visitations.

4. (a) Within 10 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 120 days from the effective date of this ORDER, the Bank shall have reduced the assets classified "Substandard" in the ROE to not more than 200 percent of Tier 1 Capital plus the ALLL.

(c) Within 180 days from the effective date of this ORDER, the Bank shall have reduced the assets classified “Substandard” in the ROE to not more than 180 percent of Tier 1 Capital plus the ALLL.

(d) Within 270 days from the effective date of this ORDER, the Bank shall have reduced the assets classified as “Substandard” in the ROE to not more than 150 percent of Tier 1 Capital plus the ALLL.

(e) Within 360 days from the effective date of this ORDER, the Bank shall have reduced the assets classified as “Substandard” in the ROE to not more than 120 percent of Tier 1 Capital plus the ALLL.

(f) Within 540 days from the effective date of this ORDER, the Bank shall have reduced the assets classified as “Substandard” in the ROE to not more than 75 percent of Tier 1 Capital plus the ALLL.

(g) The requirements of this paragraph 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 this paragraph 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 WDFI.

(h) Within 60 days from the effective date of this ORDER, the Bank shall develop written asset disposition plans for each classified asset greater than \$1,000,000. The plans shall be reviewed and approved by the Board and acceptable to the Regional Director and the Director as determined at subsequent examinations and/or visitations.

(i) 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 Director as determined at subsequent examinations and/or visitations.

5. (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. This paragraph shall not prohibit the Bank from renewing or extending the maturity of any credit in accordance with FASB 15.

(b) 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 in excess of \$50,000 that has been classified, in whole or part, "Substandard" without the prior approval of a majority of the Board or the loan committee of the Bank. The loan committee or Board shall not approve any extension of credit, or additional credit to such borrower without first collecting in cash all past due interest.

6. (a) Within 45 days from the effective date of this ORDER, the Bank shall review and 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 as to commercial real estate ("CRE") activities, concentration levels and management, and 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 Director as determined at subsequent examinations and/or visitations. 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.

7. (a) Within 45 days from the effective date of this ORDER, the Bank shall revise its lending policy to limit concentrations from CRE and Acquisition, Development, and Construction (“ADC”) loans to reasonable levels and in order to comply with the following: (i) Appendix A of Part 365 of the FDIC’S Rules and Regulations, 12 C.F.R. Part 365, Appendix A; and (ii) FIL-104-2006, Commercial Real Estate Lending Joint Guidance, dated December 12, 2006. The Bank’s lending policy and its implementation shall be acceptable to the Regional Director and Director as determined at subsequent examinations and/or visitations.

(b) Within 45 days from the effective date of this ORDER, the Bank shall develop a written plan for systematically reducing the amount of CRE and ADC loans in compliance with the lending policy required by subparagraph 7(a) of this ORDER. The Bank shall not make any new CRE or ADC loans unless: (i) the loans are in compliance with the written plan required by this subparagraph; (ii) the loans are in compliance with the provisions of subparagraph 5(b) of this ORDER; and (iii) the loans are approved by the Board. The plan and its implementation shall be acceptable to the Regional Director and Director as determined at subsequent examinations and/or visitations.

8. Within 45 days from the effective date of this ORDER, the Bank shall develop or revise, adopt, and implement a written long-term strategic plan. Such plan shall be submitted to the Regional Director and Director and shall include specific goals for the dollar volume of total loans, total investment securities, and total deposits as of December 31, 2009, December 31, 2010, December 31, 2011, and December 31, 2012. For each time frame, the plan will also specify: (i) the anticipated average maturity and average yield on loans and securities; (ii) the average maturity and average cost of deposits; (iii) the level of earning assets as a percentage of total assets; and (iv) 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 Director as determined at subsequent examinations and/or visitations.

9. (a) Within 45 days from the effective date of this ORDER, the Bank shall develop or revise, adopt, and implement a written plan addressing retention of profits, reducing overhead expenses, and setting forth a comprehensive budget. The plan required by this paragraph shall contain formal goals, strategies and benchmarks which are 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. It shall also contain a thorough description of the operating assumptions that form the basis for, and adequately support, each major component of the plan. The plan shall be in a form and manner acceptable to the Regional Director and Director as determined at subsequent examinations and/or visitations.

(b) 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 Subparagraph 9(a) 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 30 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.

11. (a) Within 45 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 addresses specific contingency plans detailing actions to be implemented under various liquidity

scenarios. Such policy shall include specific provisions to maintain a liquidity ratio (net cash, short-term, and marketable assets divided by net deposits and short-term liabilities) of at least 15 percent. This policy and implementation shall be in the form and manner acceptable to the Regional Director and the Director as determined at subsequent examinations and/or visitations.

(b) Within 45 days from the effective date of this ORDER, the Bank shall submit to the Regional Director and Director a plan to reduce the Bank's reliance on non-core funding sources, including brokered deposits and borrowing, and reduce the Bank's Non-Core Funding Dependency ratio to not more than 25 percent. The plan shall be acceptable to the Regional Director and the Director as determined at subsequent examinations and/or visitations.

12. (a) During the life of this ORDER, the Bank shall not accept, renew, or rollover any brokered deposits unless it has been applied for and been granted a waiver of this prohibition by the FDIC in accordance with the provisions of section 337.6 of the FDIC's Rules and Regulations.

(b) For purposes of this ORDER, brokered deposits are defined as described in section 337.6(a)(2) of the FDIC's Rules and Regulations, 12 C.F.R. § 337.6(a)(2).

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

14. Within 30 days from 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 Director detailing the form and manner of any actions taken to secure compliance with this ORDER and the results thereof. Such reports may be discontinued when the corrections required by this ORDER have been accomplished, and the Regional Director and the Director have released the Bank in writing from making further reports.

15. Following the effective date of this ORDER, the Bank shall provide a copy of the ORDER or otherwise furnish a description of this ORDER to its shareholder(s) in conjunction with the Bank's next shareholder communication and 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 Division of Supervision and Consumer Protection, Accounting and Securities Section, 550 17th St. NW, Washington, D.C. 20429, at least 20 days prior to dissemination to shareholders. Any changes requested 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 WDFI. 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 WDFI.

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Pursuant to delegated authority.

Dated at San Francisco, California, this 18th day of August, 2009.

/s/

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

Dated at Arlington, Washington, this 14th day of August, 2009.

/s/

Brad Williamson
Director of Banks
Washington Department of Financial Institutions