FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.
and
KANSAS OFFICE OF THE STATE BANK COMMISSIONER
TOPEKA, KANSAS

In the Matter of	
KENDALL STATE BANK **VALLEY FALLS, KANSAS**	**CONSENT ORDER**
(Insured State Nonmember Bank)	**FDIC-11-097b** **OSBC–2011-38**

The Federal Deposit Insurance Corporation ("FDIC") is the appropriate Federal banking agency for Kendall State Bank, Valley Falls, Kansas ("Bank"), under 12 U.S.C. § 1813(q).

The Bank, through its board of directors ("Board"), 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 its right to a hearing on those charges under Kansas Statutes Annotated 9-1807, and section 8(b) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. § 1818(b), and having waived those rights, entered into a STIPULATION AND CONSENT TO THE ISSUANCE OF A CONSENT ORDER ("CONSENT AGREEMENT") dated March 30, 2011, with counsel for the FDIC and with the Commissioner of the Kansas Office of the State Bank Commissioner ("OSBC"), whereby, solely for the purpose of this proceeding and without admitting or denying any unsafe or unsound banking practices, the Bank consented to the issuance of the following CONSENT ORDER (“ORDER”) by the FDIC and Kansas State Banking Board (“KSBB”).

The FDIC and KSBB considered the matter and determined that they have reason to believe that the Bank has engaged in unsafe and unsound banking practices. The FDIC and KSBB, therefore, accept the CONSENT AGREEMENT and issue the following:

1. Assessment of Management.

(a) From the effective date of this ORDER, the Bank shall take action to have and maintain qualified management.

(b) Within 30 days from the effective date of this ORDER, the Board shall engage an independent third party (“Consultant”) acceptable to the FDIC’s Regional Director for the Kansas City Region (“Regional Director”) and Commissioner of the OSBC (collectively, “Supervisory Authorities”), and that possesses appropriate expertise and qualifications to analyze and assess performance and needs of the Bank’s officers and consultants.

(c) The Bank shall provide the Supervisory Authorities with a copy of the proposed engagement letter or contract with the Consultant for review before it is executed. The contract or engagement letter, at a minimum, shall include:

(i) a description of the work to be performed under the contract or engagement letter, the fees for each significant element of the engagement, and the aggregate fee;

(ii) the responsibilities of the Consultant;

(iii) an identification of the professional standards covering the work to be performed;

(iv) identification of the specific procedures to be used when carrying out the work to be performed;

(v) the qualifications of the Consultant and its employee(s) who are to perform the work;

(vi) the time frame for completion of the work;

(vii) any restrictions on the use of the reported findings;

(viii) a provision for unrestricted examiner access to workpapers;

(ix) a certification that the Consultant and any employees are not affiliated in any manner with the Bank; and

(x) a requirement that the Consultant’s analysis and assessment shall be summarized in a written report to the board of directors (“Consultant’s Report”) within 90 days of engagement.

(d) Within 30 days of receipt of the Consultant’s Report, the Board will develop a written Management Plan that addresses the findings of the Consultant’s Report, a plan of action in response to each recommendation contained in the Consultant’s Report, and a time frame for completing each action. At a minimum, the Management Plan shall:

(i) contain a recitation of the recommendations included in the Consultant’s Report or otherwise communicated to the Bank, along with a copy of any report(s) prepared by any other outside consultants;

(ii) identify the type and number of officer positions needed to manage and supervise the affairs of the Bank, detailing any vacancies or additional needs and giving appropriate consideration to the size and complexity of the Bank;

(iii) identify the authorities, responsibilities, and accountabilities attributable to each officer;

(iv) identify the appropriate level of current and deferred compensation to each officer;

(v) evaluate the current and past performance of all existing Bank officers, indicating whether the individuals are competent and qualified to perform present and anticipated duties, adhere to the Bank’s established policies and practices, and operate the Bank in a safe and sound manner;

(vi) establish requirements and methodologies to periodically evaluate each individual’s job performance;

(vii) identify and establish Bank committees needed to provide guidance and oversight to management;

(viii) establish a plan to terminate, rotate, or reassign officers, as necessary, as well as recruit and retain qualified personnel consistent with the board's analysis and assessment of the Bank's staffing needs;

(ix) identify training and development needs, and incorporate a plan to provide such training and development;

(x) establish procedures to periodically review and update the Management Plan, as well as periodically review and assess the performance of each officer and any consultants;

(xi) contain a current organizational chart that identifies all existing and proposed officer positions, and delineates related lines of authority and accountability;

(xii) contain a current management succession plan;

(xiii) contain a procedure to ensure compliance with section 32 of the Act, 12 U.S.C. § 1831i, when applicable to changes/additions in directors and senior executive officers; and

(xiv) establish procedures to review and update the Management Plan at least annually from the effective date of this ORDER.

(e) A copy of the Consultant's Report and the Management Plan and any subsequent modification thereto shall be submitted to the Supervisory Authorities, for review and comment. Within 30 days from receipt of any comment from the Supervisory Authorities and after consideration of all such comments, the Board shall approve the Management Plan, which approval shall be recorded in the Board's minutes. Thereafter, the Bank and its directors, officers and employees shall implement and follow the Management Plan and any modifications thereto. It shall remain the responsibility of the Board to fully implement the plan within the specified time frames. In the event the plan, or any portion thereof, is not implemented, the Board shall immediately advise the Supervisory Authorities, in writing, of specific reasons for deviating from the Management Plan.

2. Minimum Capital Requirements.

(a) While this ORDER is in effect, the Bank shall have and maintain the following minimum capital ratios (as defined in Part 325 of the FDIC's Rules and Regulations), after establishing an appropriate ALLL:

(i) Tier 1 "Leverage Capital Ratio" at least equal to 8 percent; and

(ii) "Total Risk-Based Capital Ratio" at least equal to 12 percent.

(b) In the event any ratio is or becomes less than the minimum required by subparagraph (a) of this provision, the Bank shall immediately notify the Supervisory Authorities and within 30 days shall: (1) increase capital in an amount sufficient to comply with subparagraph (a) of this provision, or (2) submit an acceptable written plan to the Supervisory Authorities for review and comment, describing the primary means and timing by which the Bank shall increase its capital ratios up to or in excess of the minimum requirements set forth above, as well as a contingency plan, including the possible sale, merger, or liquidation of the Bank, in the event the primary sources of capital are not available. Within 30 days of receipt of any such comments from the Supervisory Authorities, and after consideration of all such comments, the Board shall approve the written plan and record such approval in its minutes, and the Bank shall implement and fully comply with the written plan.

(c) Any increase in Tier 1 leverage capital necessary to meet the requirements of this section may not be accomplished through a deduction from the ALLL.

3. Dividend Restriction.

While this ORDER is in effect, the Bank shall not declare or pay any dividends without the prior written approval of the Supervisory Authorities.

4. **Charge-off of Adversely Classified Assets.**

(a) Within 10 days of the effective date of this ORDER and within 10 days after the receipt of any future reports of examination of the Bank from either of the Supervisory Authorities, the Bank shall eliminate from its books, by charge-off or collection, all assets or portions of assets classified "Loss" in the November 15, 2010 Joint FDIC and OSBC Report of Examination ("Report of Examination"), and such future reports of examination that have not been previously collected or charged off.

(b) Elimination of reduction of assets through the proceeds of other loans or extensions of credit made by the Bank is not considered collection for purposes of this ORDER.

5. **Reduction of Adversely Classified Assets.**

(a) Within 90 days from the effective date of this ORDER, and 60 days from receipt of future reports of examination from either of the Supervisory Authorities, the Bank shall develop and complete a written plan to reduce the Bank's risk exposure in each asset in excess of $250,000 classified "Substandard" or "Doubtful" in the Report of Examination and in such future reports of examination. For purposes of this provision, "reduce" means to collect, charge off, or improve the quality of an asset so as to warrant its removal from such adverse classification.

(b) In developing the plans mandated by this paragraph, the Bank shall, at a minimum, review, analyze, and document the financial position of the borrower, including sources of repayment and repayment ability, as well as the value and accessibility of any pledged or assigned collateral, and any possible actions to improve the Bank’s collateral position.

(c) The plans mandated by this provision shall include, at a minimum, the following:

(i) specific action plans intended to reduce the Bank’s risk exposure in each classified asset;

(ii) a requirement that monthly written progress reports be submitted to the Board; and

(iii) a requirement that the Board review the progress reports and record with a notation of the review in the minutes of the Board meetings at which such reports are reviewed.

(d) The Board shall approve the plans, which approval shall be recorded in the minutes of the meeting of the Board for the meeting at which such plans are approved. Thereafter, a copy of the plan or portion thereof that pertains to a specific borrower shall be maintained in the borrower’s credit file, and the Bank shall implement and fully comply with the plan.

6. <u>Restrictions on Advances to Adversely Classified Borrowers</u>.

(a) While this ORDER is in effect, 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 or obligation with the Bank that has been, in whole or in part, charged off or adversely classified “Substandard” or "Doubtful" in the Report of Examination and is uncollected, or classified “Substandard” or “Doubtful” in any future FDIC or OSBC Reports of Examination and is uncollected.

(b) Subparagraph (a) of this provision 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 extending additional credit pursuant to this subparagraph (b), whether in the form of a renewal, extension, or further advance of funds, such additional credit shall be approved by the Board, who shall conclude:

(i) the failure of the Bank to extend such credit would be detrimental to the best interests of the Bank, with an explanation of why it would be detrimental;

(ii) that the extension of such credit would improve the Bank’s position, with an explanatory statement of why the Bank’s position would improve; and

(iii) an appropriate workout plan has been developed and will be implemented in conjunction with the additional credit to be extended.

(c) The conclusions and approval made pursuant to subparagraph (b) of this provision shall be made a part of the minutes of the meeting of the Board at which the extension of credit is approved, with a copy retained in the borrower's credit file.

7. <u>Concentrations of Credit</u>.

(a) Within 90 days from the effective date of this ORDER, the Bank shall develop a written plan to reduce the loan concentrations listed on the "Concentrations" page of the Report of Examination, to an amount commensurate with the Bank's business strategy, management expertise, size, and location ("Concentration Plan"). At a minimum, the Concentration Plan shall include:

(i) dollar levels and percent of capital to which the Bank shall reduce each concentration;

(ii) timeframes for achieving the reduction in dollar levels identified in response to (i) above;

(iii) provisions for the submission of monthly written progress reports to the Board for review and notation in minutes of the Board; and,

(iv) procedures for monitoring the Bank’s compliance with the plan.

(b) Upon completion of the Concentration Plan, the Board shall approve the plan, which approval shall be recorded in the Board’s minutes. Thereafter, the Bank shall implement and fully comply with the Concentration Plan.

8. Loan Review Program.

(a) Within 90 days of the effective date of this ORDER, the Board shall develop a written program of independent loan review that will provide for a periodic review of the Bank’s loan portfolio and the identification and categorization of problem credits. At a minimum, the written program shall provide for:

(i) prompt identification of loans with credit weaknesses that warrant the special attention of management, including the name of the borrower, amount of the loan, reason why the loan warrants special attention, and assessment of the degree of risk that the loan will not be fully repaid according to its terms;

(ii) identification of trends affecting the quality of the loan portfolio and potential problem areas;

(iii) assessment of the overall quality of the loan portfolio;

(iv) identification of credit and collateral documentation exceptions;

(v) identification and status of violations of laws, rules, or regulations with respect to the lending function;

(vi) identification of loans that are not in conformance with the Bank's lending policy;

(vii) identification of loans to directors, officers, principal shareholders, and their related interests; and

(viii) periodic written reports, but in no event less than quarterly, providing the information developed in (i) through (vii) above to the Board. The reports should also describe the action(s) taken by management with respect to problem credits.

(b) The written program shall be provided to the Supervisory Authorities, and shall be approved by the Board. Such approval shall be recorded in the minutes of the Board and thereafter, the Bank shall implement the written program.

(c) Upon implementation, a copy of each report submitted to the Board, as well as documentation of the actions taken by the Bank or recommendations to the Board that address identified deficiencies in specific loan relationships or the Bank's policies, procedures, strategies, or other elements of the Bank's lending activities, as well as any resulting determinations, shall be recorded and retained in the minutes of the meeting of the Board.

9. Allowance for Loan and Lease Losses ("ALLL").

The Board shall review the Bank's ALLL at least once each calendar quarter. That review should be completed at such time to ensure that the findings of the Board will be properly reported in the Bank's Call Reports. Such reviews shall, at a minimum, be made in accordance with Call Report Instructions, the Interagency Statement of Policy on the Allowance for Loan and Lease Losses, other applicable regulatory guidance that addresses the appropriateness of the ALLL, and any analysis of the ALLL provided by either of the Supervisory Authorities.

10. Liquidity and Funds Management.

Within 90 days from the effective date of this ORDER, the Bank shall review and revise its liquidity, contingency funding, and interest rate risk policies and plans, to address the concerns detailed in the Report of Examination, and specifically how the Bank will increase its liquid assets and reduce its reliance on volatile liabilities for liquidity purposes. The policies shall incorporate the guidance contained in Financial Institution Letter 13-2010, dated April 5, 2010, entitled

Funding and Liquidity Risk Management. Thereafter, the Bank shall implement and fully comply with the policies and plans.

11. <u>Business/Strategic Plan and Profit and Budget Plan</u>.

(a) Within 90 days from the effective date of this ORDER, the Board shall develop and fully implement a written three-year business/strategic plan and two-year profit and budget plan covering the overall operation of the Bank and its goals and strategies, consistent with sound banking practices, and taking into account the Bank’s other written plans, policies, or other actions as required by this ORDER.

(b) The business/strategic plan shall provide specific objectives for asset growth, loan portfolio mix, market focus, earnings projections, capital needs, and liquidity position. The profit and budget plan shall include goals and strategies for improving the earnings of the Bank. The budget shall include a description of the operating assumptions that form the basis for, and adequately support, major projected income and expense components, including projected salaries and bonuses.

(c) The Board shall approve the business/strategic plan and the profit and budget plan, which approval shall be recorded in the Board’s minutes. Thereafter, the business/strategic plan and the profit and budget plan, and any subsequent modification thereto, shall be submitted to the Supervisory Authorities, and the Bank shall implement and fully comply with the plans.

12. <u>Elimination and/or Correction of Violations of Law, Rules, and Regulations</u>.

Within 90 days from the effective date of this ORDER, the Bank shall, consistent with sound banking practices, correct all violations of laws and regulations cited by the FDIC in the Report of Examination and shall adopt and implement appropriate procedures to ensure future compliance with all such applicable federal and state laws and regulations.

13. <u>Disclosure of ORDER to Sole Shareholder</u>.

Following the effective date of this ORDER, the Bank shall provide a copy of this ORDER to its sole shareholder, (i) in conjunction with the Bank's next shareholder communication, and (ii) in conjunction with its notice or proxy statement preceding the Bank's next shareholder meeting.

14. <u>Progress Reports Detailing Compliance with ORDER</u>.

(a) Within 90 days from the effective date of this ORDER, and each 90 days thereafter, the Board shall furnish written progress reports to the Supervisory Authorities detailing the form, manner, and results of any actions taken to secure compliance with this ORDER. Such written progress reports shall provide cumulative detail of the Bank's progress toward achieving compliance with each provision of the ORDER.

(b) Progress reports may be discontinued when the Supervisory Authorities have, in writing, released the Bank from making additional reports.

MISCELLANEOUS

The provisions of this ORDER shall not bar, estop, or otherwise prevent the FDIC or any other federal or state agency, or board from taking any other action against the Bank or any of the Bank's current or former institution-affiliated parties.

The provisions of this ORDER shall be binding upon the Bank, its institution-affiliated parties, and any successors and assigns thereof.

The KSBB hereby expressly delegates the authority to the OSBC to monitor and determine compliance with the Consent Order and to pursue adequate remedies for any areas of noncompliance.

The provisions of this ORDER shall remain effective and enforceable except to the extent that and until such time as any provision has been modified, terminated, suspended, or set aside by the FDIC.

Issued Pursuant to Delegated Authority.

The ORDER shall be effective __April 8, 2011__.

By:

FEDERAL DEPOSIT INSURANCE CORPORATION

/s/____________________________________
Mark S. Moylan
Deputy Regional Director
Kansas City Regional Office

By:

KANSAS STATE BANKING BOARD

/s/____________________________________
Larry K. Williams, Chairman

/s/____________________________________
Edwin G. Splichal, Secretary