

#2002-131

**AGREEMENT BY AND BETWEEN
FIRST NATIONAL BANK OF NEWTON
NEWTON, TEXAS
AND
THE OFFICE OF THE COMPTROLLER OF THE CURRENCY**

First National Bank of Newton, Newton, Texas (Bank) and the Comptroller of the Currency of the United States of America (Comptroller) wish to protect the interests of the depositors, other customers, and shareholders of the Bank, and, toward that end, wish the Bank to operate safely and soundly and in accordance with all applicable laws, rules and regulations.

The Comptroller, through his National Bank Examiner, has examined the Bank, and his findings are contained in the Report of Examination for the examination that commenced on May 30, 2002 (ROE).

In consideration of the above premises, it is agreed, between the Bank, by and through its duly elected and acting Board of Directors (Board), and the Comptroller, through his authorized representative, that the Bank shall operate at all times in compliance with the articles of this Agreement.

ARTICLE I -- JURISDICTION

(1) This Agreement shall be construed to be a “written agreement entered into with the agency” within the meaning of 12 U.S.C. § 1818(b)(1).

(2) This Agreement shall be construed to be a “written agreement between such depository institution and such agency” within the meaning of 12 U.S.C. § 1818(e)(1) and 12 U.S.C. § 1818(i)(2).

(3) This Agreement shall be construed to be a “formal written agreement” within the meaning of 12 C.F.R. § 5.51(c)(6)(ii). *See* 12 U.S.C. § 1831i.

(4) This Agreement shall be construed to be a “written agreement” within the meaning of 12 U.S.C. § 1818(u)(1)(A).

(5) All reports or plans which the Bank or Board has agreed to submit to the Assistant Deputy Comptroller (ADC) pursuant to this Agreement shall be forwarded to:

James F. DeVane, Jr.
Assistant Deputy Comptroller
Houston East Field Office
1301 McKinney Street, Suite 3750
Houston, Texas 77010

ARTICLE II -- **BOARD TO ENSURE COMPETENT MANAGEMENT**

(1) Within sixty (60) days, the Board shall ensure that the Bank has competent management in place to carry out the Board’s policies, ensure compliance with this Agreement, applicable laws, rules and regulations, and manage the day-to-day operations of the Bank in a safe and sound manner.

(2) Within sixty (60) days, the Board shall appoint a senior officer position who shall be vested with sufficient executive authority to fulfill the duties and responsibilities of the senior lending position. The board may submit an alternative proposal to the ADC for approval. The proposal must provide for a centralized lending function.

(3) Prior to the appointment of any individual to the Senior Lending Officer position, the Board shall submit to the ADC a written description of the proposed officer’s duties and responsibilities, as well as the name and address of the proposed individual.

(4) The ADC shall have the power of veto over the appointment of this person. However, the failure to exercise such veto power shall not constitute an approval or endorsement of the proposed individual.

(5) The requirement to submit information and the prior veto provisions of this Article are based on the authority of 12 U.S.C. 1818(b) and do not require the Comptroller to complete his/her review and act on any such information or authority within ninety (90) days.

ARTICLE III -- LENDING POLICY

(1) Within sixty (60) days, the Board shall review and revise the Bank's written loan policy. In revising this policy, the Board shall refer to the Loan Portfolio Management booklet, A-LPM, of the *Comptroller's Handbook*. This policy shall incorporate, but not necessarily be limited to, the following:

- (a) a description of acceptable types of loans;
- (b) a provision that current and satisfactory credit information will be obtained on each borrower;
- (c) maturity scheduling related to the anticipated source of repayment, the purpose of the loan, and the useful life of the collateral;
- (d) maximum ratio of loan value to appraised value or acquisition costs of collateral securing the loan;
- (e) collection procedures, to include follow-up efforts, that are systematically and progressively stronger;
- (f) a definition of the Bank's trade area;
- (g) guidelines and limitations for loans originating outside of the Bank's trade area;
- (h) guidelines and limitations on concentrations of credit;

- (i) limitations on the type and size of loans that may be made by loan officers without prior approval by the Board or a committee established by the Board for this purpose;
- (j) measures to correct the deficiencies in the Bank's lending procedures noted in any ROE.
- (k) guidelines consistent with Banking Circular 255, setting forth the criteria under which renewals of extensions of credit may be approved. At a minimum the policy shall:
 - (i) ensure that renewals are not made for the sole purpose of reducing the volume of loan delinquencies; and
 - (ii) provide guidelines and limitations on the capitalization of interest;
- (l) charge-off guidelines, by type of loan or other asset, including Other Real Estate Owned, addressing the circumstances under which a charge-off would be appropriate and ensuring the recognition of losses within the quarter of discovery; and
- (m) guidelines for periodic review of the Bank's adherence to the revised lending policy.

(2) Upon adoption, the policy shall be implemented, the Board shall thereafter ensure Bank adherence to the policy, and a copy of the policy shall be forwarded to the ADC for review.

ARTICLE IV -- LOAN PORTFOLIO MANAGEMENT

(1) The Board shall, within sixty (60) days, develop, implement, and thereafter ensure Bank adherence to a written program to improve the Bank's loan portfolio management. The program shall include, but not be limited to:

- (a) procedures to ensure satisfactory and perfected collateral documentation;
- (b) procedures to ensure that extensions of credit are granted, by renewal or otherwise, to any borrower only after obtaining and analyzing current and satisfactory credit information;
- (c) procedures to ensure conformance with loan approval requirements;
- (d) a system to track and analyze exceptions;
- (e) procedures to ensure conformance with Call Report instructions;
- (f) a performance appraisal process, including performance appraisals, job descriptions, and incentive programs for loan officers, which adequately consider their performance relative to policy compliance, documentation standards, accuracy in credit grading, and other loan administration matters.

(2) Upon completion, a copy of the program shall be forwarded to the ADC.

(3) Effective immediately, the Bank may grant, extend, renew, alter or restructure any

loan or other extension of credit only after:

- (a) documenting the specific reason or purpose for the extension of credit;
- (b) identifying the expected source of repayment in writing;
- (c) structuring the repayment terms to coincide with the expected source of repayment;
- (d) obtaining and analyzing current and satisfactory credit information, including cash flow analysis, where loans are to be repaid from operations;
 - (i) Failure to obtain the information in (2)(d) shall require a majority of the full Board (or a delegated committee thereof) to certify in

writing the specific reasons why obtaining and analyzing the information in (2)(d) would be detrimental to the best interests of the Bank.

(ii) A copy of the Board certification shall be maintained in the credit file of the affected borrower(s). The certification will be reviewed by this Office in subsequent examinations of the Bank; and

(e) documenting, with adequate supporting material, the value of collateral and properly perfecting the Bank's lien on it where applicable.

(4) Within sixty (60) days, the Board shall develop, implement, and thereafter ensure Bank adherence to systems which provide for effective monitoring of:

(a) early problem loan identification to assure the timely identification and rating of loans and leases;

(b) previously charged-off assets and their recovery potential;

(c) compliance with the Bank's lending policies and laws, rules, and regulations pertaining to the Bank's lending function;

(d) adequacy of credit and collateral documentation; and

(e) concentrations of credit.

(5) Beginning December 31, 2002, management will provide the Board with quarterly written reports including, at a minimum, the following information:

(a) the identification, type, rating, and amount of problem loans and leases;

(b) the identification and amount of delinquent loans and leases;

(c) credit and collateral documentation exceptions;

- (d) the identification and status of credit related violations of law, rule or regulation;
- (e) the identity of the loan officer who originated each loan reported in accordance with subparagraphs (a) through (d) of this Article and Paragraph;
- (f) the identification and amount of loans and leases to executive officers, directors, principal shareholders (and their related interests) of the Bank; and
- (g) the identification of loans and leases not in conformance with the Bank's lending and leasing policies, and exceptions to the Bank's lending and leasing policies.

ARTICLE V -- INTERNAL LOAN REVIEW

(1) The Board shall within sixty (60) days employ or designate a sufficiently experienced and qualified person(s) or firm to ensure the timely and independent identification of problem loans and leases.

(2) Within ninety (90) days, the Board shall establish an effective, independent and on-going loan review system to review, at least quarterly, the Bank's loan and lease portfolios to assure the timely identification and categorization of problem credits. The system shall provide for a written report to be filed with the Board after each review and shall use a loan and lease grading system consistent with the guidelines set forth in RATING CREDIT RISK, A-RCR, of the *Comptroller's Handbook*. Such reports shall, at a minimum, include conclusions regarding:

- (a) the overall quality of the loan and lease portfolios;
- (b) the identification, type, rating, and amount of problem loans and leases;

- (c) the identification and amount of delinquent loans and leases;
- (d) credit and collateral documentation exceptions;
- (e) the identification and status of credit related violations of law, rule or regulation;
- (f) the identity of the loan officer who originated each loan reported in accordance with subparagraphs (b) through (e) of the Article;
- (g) concentrations of credit;
- (h) loans and leases to executive officers, directors, principal shareholders (and their related interests) of the Bank; and
- (i) loans and leases not in conformance with the Bank's lending and leasing policies, and exceptions to the Bank's lending and leasing policies.

(3) A written description of the program called for in this Article shall be forwarded to the ADC upon implementation.

(4) A copy of the reports submitted to the Board, as well as documentation of the action taken by the Bank to collect or strengthen assets identified as problem credits, shall be preserved in the Bank.

ARTICLE VI -- CRITICIZED ASSETS

(1) The Bank shall take immediate and continuing action to protect its interest in those assets criticized in the ROE, in any subsequent Reports of Examination, by internal or external loan review, or in any list provided to management by the National Bank Examiners during any supervisory activity.

(2) Within sixty (60) days, the Board shall adopt, implement, and thereafter ensure Bank adherence to a written program designed to eliminate the basis of criticism of assets

criticized in the ROE, in any subsequent Reports of Examination, or by any internal or external loan review, or in any list provided to management by the National Bank Examiners during any examination as "doubtful," "substandard," or "special mention." This program shall include, at a minimum:

- (a) an identification of the expected sources of repayment;
- (b) the appraised value of supporting collateral and the position of the Bank's lien on such collateral where applicable;
- (c) an analysis of current and satisfactory credit information, including cash flow analysis where loans are to be repaid from operations; and
- (d) the proposed action to eliminate the basis of criticism and the time frame for its accomplishment.

(3) Upon adoption, a copy of the program for all criticized assets equal to or exceeding \$100 thousand dollars (\$100,000) shall be forwarded to the ADC.

(4) The Board, or a designated committee, shall conduct a review, on at least a quarterly basis, to determine:

- (a) the status of each criticized asset or criticized portion thereof that equals or exceeds \$100 thousand dollars (\$100,000);
- (b) management's adherence to the program adopted pursuant to this Article;
- (c) the status and effectiveness of the written program; and
- (d) the need to revise the program or take alternative action.

(5) A copy of each review shall be forwarded to the ADC on a quarterly basis (in a format similar to Appendix A, attached hereto).

(6) The Bank may extend credit, directly or indirectly, including renewals, extensions or capitalization of accrued interest, to a borrower whose loans or other extensions of credit are criticized in the ROE, in any subsequent Report of Examination, in any internal or external loan review, or in any list provided to management by the National Bank Examiners during any examination and whose aggregate loans or other extensions exceed \$100 thousand (\$100,000) only if each of the following conditions is met:

- (a) the Board or designated committee finds that the extension of additional credit is necessary to promote the best interests of the Bank and that prior to renewing, extending or capitalizing any additional credit, a majority of the full Board (or designated committee) approves the credit extension and records, in writing, why such extension is necessary to promote the best interests of the Bank; and
- (b) a comparison to the written program adopted pursuant to this Article shows that the Board's formal plan to collect or strengthen the criticized asset will not be compromised.

(7) A copy of the approval of the Board or of the designated committee shall be maintained in the file of the affected borrower.

ARTICLE VII -- JAMES HUGHES, SR. AND RELATED ENTITIES

(1) From the effective date of this Agreement, the Bank is prohibited from entering into any new Business Transaction with James Hughes, Sr., his spouse, children, parents or siblings, any person who acts in Mr. Hughes' behalf, and any of Mr. Hughes' or the foregoing persons' Related Interests.

(2) Appropriately secured consumer transactions to Mr. Hughes' relatives or associates are not covered by this prohibition, so long as the transactions does not benefit, directly or indirectly, Mr. Hughes.

(3) This prohibition shall continue until terminated by the Comptroller.

ARTICLE VIII -- INTERNAL AUDIT

(1) Within 60 (sixty) days, the Board shall adopt, implement, and thereafter ensure Bank adherence to an independent, internal audit program sufficient to:

- (a) detect irregularities in the Bank's operations;
- (b) determine the Bank's level of compliance with all applicable laws, rules and regulations;
- (c) evaluate the Bank's adherence to established policies and procedures, with particular emphasis directed to the Bank's adherence to its loan policies concerning underwriting standards and problem loan identification and classification;
- (d) ensure adequate audit coverage in all areas; and
- (e) establish an annual audit plan using a risk based approach sufficient to achieve these objectives.

(2) As part of this audit program, the Board shall evaluate the audit reports of any party providing services to the Bank, and shall assess the impact on the Bank of any audit deficiencies cited in such reports.

(3) The Board shall ensure that the audit function is supported by an adequately staffed department or outside firm, with respect to both the experience level and number of the individuals employed.

(4) The Board shall ensure that the audit program is independent. The persons responsible for implementing the internal audit program described above shall report directly to the Board, that shall have the sole power to direct their activities. All reports prepared by the audit staff shall be filed directly with the Board and not through any intervening party.

(5) All audit reports shall be in writing. The Board shall ensure that immediate actions are undertaken to remedy deficiencies cited in audit reports, and that auditors maintain a written record describing those actions.

(6) The audit staff shall have access to any records necessary for the proper conduct of its activities. National bank examiners shall have access to all reports and work papers of the audit staff and any other parties working on its behalf.

(7) Upon adoption, a copy of the internal audit program shall be promptly submitted to the ADC.

ARTICLE IX -- **STRATEGIC PLAN**

(1) Within one hundred-twenty (120) days, the Board shall develop a strategic plan that is consistent with the goals, objectives, and the overall risk profile established for the bank. At a minimum, the plan will consist of the following:

- (a) Defined assumptions and measurable goals;
- (b) Capital adequacy;
- (c) Detailed monthly balance sheet and income statement;
- (d) Product offering;
- (e) Staffing needs; and,
- (f) Expansion initiatives.

(2) Monthly reports comparing actual performance to budget projections will be made a part of the monthly Board meeting information. Management will provide written explanations of significant variances between actual performance and budget projections.

(3) Upon completion of the actions required by (1), the Board will provide a copy of its strategic plan to the ADC for review.

ARTICLE X -- CONFLICT OF INTEREST POLICY

(1) Within 90 (ninety) days, the Board shall adopt, implement, and thereafter ensure Bank adherence to a written, comprehensive conflict of interest policy applicable to the Bank's and the Bank's holding company's directors, principal shareholders, executive officers, affiliates, and employees (Insiders) and related interests of such Insiders. The policy, in addition to defining a conflict of interest, shall address:

- (a) avoidance of conflicts of interest and breaches of fiduciary duty, and the appearance of conflicts of interest;
- (b) involvement in the loan approval process of Insiders who may benefit directly or indirectly from the decision to grant credit;
- (c) disclosure of actual and potential conflicts of interest to the Board, and periodic disclosure of "related interests" as defined by 12 C.F.R. Part 215;
- (d) requirements for arms-length dealing in any transactions by Insiders, or their related organizations, involving the Bank's sale, purchase, or rental of property and services;
- (e) disclosure of any Insider's material interest in the business of a borrower, an applicant, or other customer of the Bank; and,

- (f) restrictions on and disclosure of receipt of anything of value by Insiders, directly or indirectly, from borrowers, loan applicants, other customers, or suppliers of the Bank.

(2) Within ninety (90) days, the Board shall adopt and implement a program to identify, report, and monitor activities in the bank that pose potential conflicts of interest. The program shall include procedures:

- (a) to ensure the transaction does not violate applicable laws and regulations;
- (b) to ensure the transaction is made on terms and under circumstances that are substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other companies or individuals who are not Insiders or related interests of Insiders;
- (c) preceded by a finding by the Board that the primary purpose of the Business Transaction is to further the best interests of the Bank; and
- (d) to ensure advanced approval by a majority of the entire Board, not merely a quorum thereof, with any interested Insider abstaining from voting and participating directly or indirectly in the deliberations regarding the approval.

(3) Upon adoption, a copy of this conflict of interest policy shall be forwarded to the ADC for review.

ARTICLE XI -- CLOSING

(1) Although the Board has agreed to submit certain programs and reports to the ADC for review or approval, the Board has the ultimate responsibility for proper and sound management of the Bank.

(2) The Board shall ensure that the Bank has processes, personnel, and control systems to ensure implementation of and adherence to the policy developed pursuant to this Article.

(3) It is expressly and clearly understood that if, at any time, the Comptroller deems it appropriate in fulfilling the responsibilities placed upon him/her by the several laws of the United States of America to undertake any action affecting the Bank, nothing in this Agreement shall in any way inhibit, estop, bar, or otherwise prevent the Comptroller from so doing.

(4) Any time limitations imposed by this Agreement shall begin to run from the effective date of this Agreement. Such time requirements may be extended in writing by the ADC for good cause upon written application by the Board.

(5) The provisions of this Agreement shall be effective upon execution by the parties hereto and its provisions shall continue in full force and effect unless or until such provisions are amended in writing by mutual consent of the parties to the Agreement or excepted, waived, or terminated in writing by the Comptroller.

(6) In each instance in this Agreement in which the Board is required to ensure adherence to, and undertake to perform certain obligations of the Bank, it is intended to mean that the Board shall:

- (a) authorize and adopt such actions on behalf of the Bank as may be necessary for the Bank to perform its obligations and undertakings under the terms of this Agreement;
- (b) require the timely reporting by Bank management of such actions directed by the Board to be taken under the terms of this Agreement;
- (c) follow-up on any non-compliance with such actions in a timely and appropriate manner; and
- (d) require corrective action be taken in a timely manner of any non-compliance with such actions.

(7) This Agreement is intended to be, and shall be construed to be, a supervisory “written agreement entered into with the agency” as contemplated by 12 U.S.C. § 1818(b)(1), and expressly does not form, and may not be construed to form, a contract binding on the OCC or the United States. Notwithstanding the absence of mutuality of obligation, or of consideration, or of a contract, the OCC may enforce any of the commitments or obligations herein undertaken by the Bank under its supervisory powers, including 12 U.S.C. § 1818(b)(1), and not as a matter of contract law. The Bank expressly acknowledges that neither the Bank nor the OCC has any intention to enter into a contract. The Bank also expressly acknowledges that no OCC officer or employee has statutory or other authority to bind the United States, the U.S. Treasury Department, the OCC, or any other federal bank regulatory agency or entity, or any officer or employee of any of those entities to a contract affecting the OCC’s exercise of its supervisory responsibilities. The terms of this Agreement, including this paragraph, are not subject to amendment or modification by any extraneous expression, prior agreements or arrangements, or negotiations between the parties, whether oral or written.

IN TESTIMONY WHEREOF, the undersigned, authorized by the Comptroller, has hereunto set his hand on behalf of the Comptroller.

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| <u>Debrah A. Brock Acting Assistant Deputy Comptroller</u> For James F. DeVane, Jr. | <u>12/17/02</u> Date |
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AND IN FURTHER TESTIMONY WHEREOF, the undersigned, as the duly elected and acting Board of Directors of the Bank, have hereunto set their hands on behalf of the Bank.

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| <u>Signed</u> Lin M. Bingham | <u>12/17/02</u> Date |
| <u>Signed</u> R.C. Hext | <u>12-17-02</u> Date |
| <u>Signed</u> Robert G. Latiolas II | <u>12-17-02</u> Date |
| <u>Signed</u> Dennis R. Mott | <u>12/17/02</u> Date |
| <u>Signed</u> Thomas R. Rash | <u>12/17/02</u> Date |
| <u>Signed</u> Bobby G. Rozas | <u>12/17/02</u> Date |
| <u>Signed</u> Lew C. Sheffler | <u>12/17/02</u> Date |
| <u>Signed</u> Carlos R. Vacek | <u>12-17-02</u> Date |
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