95261

Legal Docket

SUPERVISORY AGREEMENT

This Supervisory Agreement ("Agreement") is made and is effective this 20th day of December, 1990, by and between FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF HARRISBURG (OTS No. 4965), hereinafter referred to as "FIRST FEDERAL", for itself and any wholly-owned or majority owned subsidiary and the Office of Thrift Supervision ("OTS"). This Agreement has been duly authorized, executed, and delivered, and constitutes, in accordance with its terms, a valid and binding obligation of FIRST FEDERAL and the OTS. It is understood and agreed that this Agreement is a "written agreement" entered into with the OTS, as that term is used in 12 U.S.C. §1818(b).

WHEREAS, the OTS is of the opinion, based on the results of the April 2, 1990 Report of Examination ("Report"), that certain supervisory concerns contained in the Report should be addressed in this Agreement; and

WHEREAS, the OTS is willing to forbear at this time from the initiation of formal supervisory proceedings against FIRST FEDERAL, so long as FIRST FEDERAL is in substantial compliance with the provisions of this Agreement; and

WHEREAS, although FIRST FEDERAL neither admits nor denies the matters contained in the Report, in the interest of regulatory compliance and cooperation, FIRST FEDERAL is willing to enter into this Agreement to avoid the initiation of such proceedings:

NOW, THEREFORE, in consideration of the above-stated forbearance by the OTS, it is agreed between the parties hereto as follows:

1. Within ninety (90) days of the effective date of this Agreement, FIRST FEDERAL'S Board shall develop, adopt and file with the District Director of the Office of Thrift Supervision/Third District ("District Director"), a plan for strengthening FIRST FEDERAL'S management ("Management Plan"). The Management Plan shall include an accurate assessment and performance evaluation of the active management of FIRST FEDERAL prepared for the board of directors by an experienced independent management consultant. Prior to engagement of the management consultant firm, the Board shall provide notice to the District Director or his designee as to the identity and qualifications of the firm it intends to employ. In the event the District Director or his designee does not object to the engagement of the identified firm within five (5) days of such notice, the Board may employ the firm to conduct the management study. Once selected, the Board shall inform the District Director of its selection.

   The management consultant shall be required to reach specific conclusions and make specific recommendations regarding management in the following areas:

   o written job descriptions for each senior officer, including the qualifications of each member of FIRST FEDERAL's senior officers to perform assigned duties;

- an evaluation of the performance of each senior officer of FIRST FEDERAL with a conclusion reached as to the adequacy of the officer's performance;

- a copy of FIRST FEDERAL'S organization chart;

- identification of current lines of authority, reporting responsibilities and delegation of duties for all officers and the internal auditor, including identification of any overlapping duties or responsibilities;

- an evaluation of the capability of each senior officer to assume the Presidency of FIRST FEDERAL;

- an evaluation of the Board's performance in conducting the affairs of FIRST FEDERAL and oversight of management;

- an evaluation of the adequacy and capacity of FIRST FEDERAL'S senior officers to achieve the goals and objectives of FIRST FEDERAL'S business plan;

- a discussion of the ability of FIRST FEDERAL'S management to correct the deficiencies outlined in the Report, particularly the areas of real estate management of distressed assets (notably the properties located in FIRST FEDERAL'S Southwest portfolio), regulatory compliance, strategic planning, policy development and service corporations;

O

- a review of FIRST FEDERAL'S incentive bonus program, including the amount of bonuses paid to officers during the past three years;

- implementation strategy to address each recommendation in the management consultant's report, including time frames.

It shall remain the responsibility of the Board to fully implement the Management Plan within the specified time frames. In the event the Management Plan, or any portion thereof, is not implemented, the Board shall immediately advise the District Director, in writing, of specified reasons for deviating from the Management Plan.

2. Within sixty (60) days of the effective date of this Agreement, FIRST FEDERAL shall adopt a policy designed to maintain adequate general valuation allowances ("GVA") in accordance with the requirements of 12 C.F.R. 563.160(d)(3). The GVA policy shall be developed in accordance with the guidelines on maintaining a proper GVA, as discussed in Section 261 of the Office of Thrift Supervision's Thrift Activities Handbook (pp.261.1 - 261.4) and shall focus particular attention on the following factors:

   a. results of FIRST FEDERAL'S internal loan review;

   b. loan loss experience;

c. an estimate of potential loss exposure on each significant credit;

d. concentrations of credit in FIRST FEDERAL;

e. present and prospective economic conditions (especially in the Southwest);

f. loans criticized by the examiner or identified by FIRST FEDERAL'S internal loan review;

g. trends of delinquent and/or nonaccrual loans;

h. charge-off, collection, and recovery policies and procedures and their effectiveness; and

i. level, severity and trend of classified assets.

The Board shall cause the GVA to be maintained at a prudent level in accordance with the guidelines set forth in FIRST FEDERAL'S policy. Additionally, the policy shall provide for a review of the GVA by the Board at least once each calendar quarter. Any deficiency in the GVA shall be remedied in the quarter it is discovered, prior to the filing of FIRST FEDERAL'S Thrift Financial Report, by an additional provision from earnings. Written documentation shall be maintained indicating the factors considered and conclusions reached by the Board in determining the adequacy of the GVA.

3. Within thirty (30) days of the effective date of this Agreement, FIRST FEDERAL shall provide written confirmation to the District Director or his designee that FIRST FEDERAL has established specific reserves or charged off the additional amount of $700,515 in accordance with 12 C.F.R. Section 563.160(d)(2).

4. Within sixty (60) days of the effective date of this Agreement, FIRST FEDERAL shall expand its internal loan review policy and self classification of assets system to be in accordance with Thrift Bulletin 3 and 12 C.F.R. 563.160 (c)(2). The internal loan review and classification system shall identify criteria to be reviewed in determining adequate GVA and specific reserves to ensure the integrity of the financial reports, with particular attention to the following areas:

   a. criteria to promote the early identification of credit weaknesses;

   b. the need for current rent rolls and financial information, updated appraisal reports and related relevant information; and

   c. guidelines to provide senior management and the Board with an objective assessment of the overall quality of the loan portfolio; and

   The Board can review Section 210 of the Office of Thrift Supervision's Thrift Activities Handbook or Thrift Bulletin 3 for further guidance on this subject.

5. FIRST FEDERAL shall take immediate and continuing action to protect its interest with regard to those assets criticized in the Report. Furthermore, and within ninety (90) days of the effective date of this Agreement, the Board shall adopt and cause to be implemented a written program designed to eliminate the basis of criticism of assets criticized in the Report as "Doubtful," "Substandard," or "assets specially mentioned." This program shall include, at a minimum, the following:

(a) work-out plans which outline specific actions First Federal intends to take to eliminate the deficiencies noted with respect to each asset and time frames for their accomplishment;

(b) an identification of the expected sources of repayment; and

(c) an analysis, to the extent available, of current and satisfactory credit information, including cash flow analysis where loans are to be repaid from operations.

6. Pursuant to paragraph five (5) of this Agreement, the Board, or a delegated committee thereof (which may include, but shall not comprise a majority thereof, officers who are not directors), shall conduct a review, on at least a quarterly basis, to determine:

(a) the status of each criticized asset or criticized portion thereof;

(b) management's adherence to the programs adopted;

(c) the status and effectiveness of the written programs; and

(d) the need to revise the programs or take alternative action.

A copy of each review shall be forwarded to the OTS at its Office located in Pittsburgh, Pennsylvania.

7. FIRST FEDERAL shall maintain such records required by 12 C.F.R. 563.170 in order to provide an accurate, complete and timely record of all business transacted by FIRST FEDERAL. Furthermore, the documents, files and other material comprising said records shall be at all times available for examination or audit.

8. Within ninety (90) days of the effective date of this Agreement, the Board of Directors shall cause an internal audit to be made by and certified by the internal auditor of all non sufficient fund (NSF) checks written by any director, officer, or employee of FIRST FEDERAL since January 1, 1987. The scope of the audit must be approved by the District Director and include, at a minimum, the following items:

   a. The date, amount, and payee of each NSF check written by any director, officer or employee;

   b. A list of the above NSF checks which were returned unpaid and those for which the institution advanced funds resulting in an overdraft for the particular individual's account;

c. Number of days any such individual's account was overdrawn, after each overdraft;

d. The number and aggregate amount of fees charged to any such individual for overdrafts and similar information concerning waived fees;

e. Identification of FIRST FEDERAL personnel approving any overdrafts of the type noted in (b) above, along with advice as to the reason(s) for said approval; and

f. Identification of any loss, actual or projected, from the NSF check of a director, officer, or employee.

The result of said audit should be promptly filed with the District Director at the Pittsburgh Office.

9. Within sixty (60) days of the effective date of this Agreement, FIRST FEDERAL'S Board shall update and approve the current internal audit program and develop a policy to address circumstances when directors, officers, or employees issue NSF checks or overdrafts. The audit program shall be revised and tailored to the operations of FIRST FEDERAL, and at a minimum, correct the areas of weaknesses discussed on pages seventeen through nineteen of the Report. Furthermore, the audit program should provide for a periodic review of compliance with 12 C.F.R. Part 215 (Regulation O). The NSF policy shall be promptly filed with the District Director or his designee.

O

10. Within ninety (90) days of the effective date of this Agreement, the Board shall expand its loan underwriting guidelines to include policies and procedures governing the issuance of letters of credit. The letter of credit policy shall thoroughly explain FIRST FEDERAL'S procedures in issuing both commercial and standby letters of credit. Furthermore, the policy shall contain guidelines with respect to compliance with 12 C.F.R. 545.48 and include the following items:

(a) an outline of desirable and undesirable issuances;

(b) designated persons authorized to issue letters of credit; and

(c) the recordkeeping and documentation requirements, including the need to establish separate files for each issuance.

If several departments issue letters of credit, the policy should be explicit in charging responsibility for file maintenance and recordkeeping. The letter of credit policy shall be promptly filed with the District Director or his designee.

11. Within sixty (60) days of the effective date of this Agreement, the Board shall develop and adopt a written policy to guide management when purchasing sales contracts from home improvement dealers. The policy shall include the underwriting procedures currently being performed by management and incorporate the recommendations proposed by the examiner on page eleven of the Report. Upon completion, the policy shall be promptly filed with the District Director or his designee.

O

12. Within ninety (90) days of the effective date of this Agreement, the Board shall expand its loan underwriting guidelines to include policies which address environmental related hazards and risks associated with major borrowers. The Board shall utilize Thrift Bulletin 16 and Thrift Activities Handbook Section 210 as a guide in developing the environmental related hazards policy. When completed, a copy of the policy shall be promptly filed with the District Director or his designee.

13. Within sixty (60) days of the effective date of this Agreement, the Board shall develop and adopt a written conflict of interest policy. Furthermore, the Board shall establish a written policy governing transactions between insiders and employees which conforms to the requirements of 12 C.F.R. Part 215 (Regulation O). The policy should be designed to prevent violations of Regulation O and should ensure that individual Directors are aware of their obligations under the regulation. FIRST FEDERAL shall file a copy of each policy with the District Director when completed.

14. Within sixty (60) days of the effective date of this Agreement, the Board shall revise the investment policy to eliminate the areas of concerns identified by the examiners on pages eleven and twelve of the Report.

15. FIRST FEDERAL shall prepare all future periodic thrift reports in accordance with applicable instructions and 12 C.F.R. 563.180(a).

16. Within sixty (60) days of the effective date of this Agreement, the Board shall confirm with the District Director or his designee that management has taken steps to integrate the interest rate risk policy requirements into daily operations. Such requirements are detailed on pages twelve and thirteen of the Report and include, but are not limited to, the following items:

(a) The asset liability management committee ("ALCO") should be appointed by the Board and meet monthly;

(b) accurate minutes shall be taken of each ALCO meeting; and

(c) the Board limits established on percentage change in net interest income and market value of portfolio equity shall be adjusted if they do not closely follow empirical results.

17. Within sixty (60) days of the effective date of this Agreement, the Board shall confirm with the District Director or his designee that management has taken steps to effectively integrate FIRST FEDERAL'S appraisal policy into daily operations. To ensure effective implementation of the appraisal policy, management shall perform, at a minimum, the following functions:

a) Each appraisal report shall be reviewed by the appropriate staff member and documentation of such review shall be maintained; and

b) a performance review of all appraisers employed by FIRST FEDERAL shall be conducted on an annual basis.

O

18. Within ninety (90) days of the effective date of this Agreement, FIRST FEDERAL shall file with the District Director or his designee, a revised business plan of at least a three-year duration, setting forth the time period covered by the plan, the person(s) responsible for implementation of the plan, a statement of the general descriptive outline of the plan including quantitative information, and a statement of specific goals and actions. Furthermore, the plan shall be adopted by the full board of directors and reviewed on an annual basis. Management can utilize OTS Memorandum "Business Plan Requirements" found in Supervisory Release 90-22 as a guide when preparing the plan.

19. Within ninety (90) days of the effective date of this Agreement, FIRST FEDERAL shall submit to the District Director or his designee a copy of written policies and procedures developed by the board of directors of Avstar Service Corporation, to guide its mortgage origination and sales activities. The policy shall include, at a minimum, the following items:

a. A risk management strategy which includes guidelines outlining the acceptable level of interest rate risk, procedures for monitoring and adjusting the amount of pipeline coverage, and adherence to a strategy of moving warehouse inventory out regardless of whether or not the loans can be sold at a favorable spread;

b. a quality control strategy which addresses efficient processing to provide customer service and adequately controls the quality and integrity of loan products sold to investors;

O

c. geographic market area for loan originations;

d. the type of mortgage loans to be originated or purchased;

e. the estimated annual volume of loan originations and purchases;

f. limits on the volume of loans to be purchased from or sold to third parties;

g. a written appraisal policy as required by 12 C.F.R. 563.171(c); and

h. a written policy for the underwriting and financing of owner built construction loans.

20. Beginning with the effective date of this Agreement, the minutes of Avstar's board of directors meetings shall be promptly recorded and clearly reflect the level of supervision exercised over the affairs of the subsidiary by its board. In addition, the minutes should adequately reflect all relevant discussions that transpire during the meetings.

21. Within thirty (30) days of the effective date of this Agreement, the Board shall certify to the District Director that FIRST FEDERAL'S subordination of its first lien position for a $10 million line of credit to Avstar, to First Pennsylvania Bank's $10 million line of credit, does not in effect guarantee First Pennsylvania's line of credit by FIRST FEDERAL. Such certification

shall be accompanied by a reasoned legal opinion, including copies of all relevant documents, from FIRST FEDERAL'S solicitor, addressing this issue. The legal opinion shall also confirm that FIRST FEDERAL'S service corporations are in full compliance with 12 C.F.R. 545.74 and 12 C.F.R. 571.21.

22. Any determinations by the Director or his designee as to the adequacy of or compliance with the various policies and procedures required to be submitted pursuant to this Agreement will be subject to verification of management adherence to said policies and procedures during the subsequent examination(s) of FIRST FEDERAL and its subsidiaries.

23. Upon written request by FIRST FEDERAL and a showing of good cause, the time frames for submission of policies and procedures and other performance by FIRST FEDERAL, as specified in this Agreement, may be extended by the District Director or his designee.

The Board shall take whatever steps are necessary to ensure full compliance by FIRST FEDERAL with the requirements of this Agreement.

All technical words or terms used in this Agreement, for which meanings are not specified or otherwise provided by the provisions of this Agreement, shall insofar as applicable, have meanings as defined in Chapter V of Title 12 of the Code of Federal Regulations, and any such technical words or terms used in this Agreement and undefined in said Code of Federal Regulations shall have meanings that accord with the best custom and usage in the savings and loan industry.

O

The terms and provisions of this Agreement shall be binding upon, and inure to the benefit of, the parties hereto and their successors in interest.

This Agreement shall remain in effect until terminated, modified, or suspended by the OTS, acting through the District Director of the Third District Office (Pittsburgh Office).

IN WITNESS WHEREOF, the OTS acting through the District Director for the Pittsburgh Office, and FIRST FEDERAL, by its duly elected directors, have executed this Agreement on the date first above written..

FIRST FEDERAL SAVINGS AND LOAN
ASSOCIATION OF HARRISBURG
By the Board of Directors:

/S/

/S/

/S/

/S/

/S/

/S/

OFFICE OF THRIFT SUPERVISION

By: /S/
District Director or
His Designee

O