

UNITED STATES OF AMERICA  
BEFORE THE  
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON, D.C.

STATE OF COLORADO  
DIVISION OF BANKING  
DENVER, COLORADO

Written Agreement by and among

FARMERS BANK  
Ault, Colorado

FEDERAL RESERVE BANK OF KANSAS CITY  
Kansas City, Missouri

and

COLORADO DIVISION OF BANKING  
Denver, Colorado

Docket Nos. 10-089-WA/RB-SM

WHEREAS, in recognition of their common goal to maintain the financial soundness of Farmers Bank, Ault, Colorado (the “Bank”), a state-chartered bank that is a member of the Federal Reserve System, the Bank, the Federal Reserve Bank of Kansas City (the “Reserve Bank”), and the Colorado Division of Banking (the “Division”) have mutually agreed to enter into this Written Agreement (the “Agreement”); and

WHEREAS, on May 17, 2010, the Bank’s board of directors, at a duly constituted meeting, adopted a resolution authorizing and directing Fred J. Bauer to enter into this Agreement on behalf of the Bank, and consenting to compliance with each and every applicable provision of this Agreement by the Bank and its institution-affiliated parties, as defined in

section 3(u) of the Federal Deposit Insurance Act, as amended (the “FDI Act”) (12 U.S.C. § 1818(3)(u)).

NOW, THEREFORE, the Bank, the Reserve Bank, and the Division agree as follows:

### **Board Oversight**

1. Within 60 days of this Agreement, the board of directors of the Bank shall submit to the Reserve Bank and the Division a written plan to strengthen board oversight of the management and operations of the Bank. The plan shall, at a minimum, address, consider, and include:

(a) The actions that the board of directors will take to improve the Bank’s condition and maintain effective control over and supervision of the Bank’s senior management, major operations, and activities, including but not limited to, asset quality, problem loan identification, credit risk management, loan review, loan administration, funds management, processes to mitigate risks associated with credit concentrations, and earnings;

(b) the responsibility of the board of directors to monitor management’s adherence to approved Bank policies and procedures, and applicable laws and regulations; and

(c) a description of the information and reports that will be regularly reviewed by the board of directors in its oversight of the operations and management of the Bank, including information on the Bank’s newly extended and renewed loans, adversely classified assets, concentrations of credits, allowance for loan and lease losses (“ALLL”), capital, liquidity, and earnings.

### **Management Review**

2. (a) Within 30 days of this Agreement, the board of directors of the Bank shall retain an independent consultant acceptable to the Reserve Bank and the Division to assess: (i)

the Bank's senior management and loan officer staffing needs; and (ii) the qualifications and performance of all senior executive officers, including their ability to: adhere to applicable laws and regulations and the Bank's established policies and procedures; restore and maintain the Bank to a safe and sound condition; and comply with the requirements of this Agreement (the "Management Review"). The independent consultant shall prepare a written report of findings and recommendations (the "Report").

(b) Within 10 days of the Reserve Bank's and the Division's approval of the Bank's independent consultant selection, the Bank shall submit an engagement letter to the Reserve Bank and the Division for approval. The engagement letter shall require the independent consultant to submit the Report within 30 days of regulatory approval of the engagement letter and to provide a copy of the Report to the Reserve Bank and the Division at the same time it is provided to the Bank's board of directors.

3. Within 30 days of receipt of the Report or receipt of all approvals of the Reserve Bank and the Division required by paragraphs 2(a) and (b) of this Agreement, whichever is later, the Bank's board of directors shall submit a written management plan to the Reserve Bank and the Division that fully addresses the findings and recommendations in the independent consultant's Report and describes the specific actions that the board of directors proposes to take in order to strengthen the Bank's management and hire, as necessary, additional or replacement officers or staff to properly manage and operate the Bank.

### **Credit Risk Management**

4. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written plan to strengthen credit risk management practices. The plan shall, at a minimum, address, consider, and include:

- (a) The responsibility of the Bank's board of directors to establish appropriate risk tolerance guidelines and risk limits;
- (b) procedures to periodically review and revise risk exposure limits to address changes in market conditions;
- (c) strategies to minimize credit losses and reduce the level of problem assets;
- (d) procedures to identify, limit, and manage concentrations of credit that are consistent with the Interagency Guidance on Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices, dated December 12, 2006 (SR 07-1);
- (e) a schedule for reducing and the means by which the Bank will reduce the level of commercial real estate ("CRE") concentrations, and timeframes for achieving the reduced levels; and
- (f) enhanced monitoring and reporting of CRE concentrations to management and the board of directors.

### **Lending and Credit Administration**

5. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable enhanced written lending and credit administration program that shall, at a minimum, address, consider, and include:

- (a) Underwriting standards that require documented analyses of: (i) the borrower's repayment sources, global cash flow, and overall debt service ability; and (ii) the value of any collateral;
- (b) standards for renewing, extending, or modifying existing loans, including, but not limited to, the capitalization of interest, and approval and documentation requirements;

(c) procedures for the periodic analyses, during the term of the loan, of: (i) the borrower's repayment sources, global cash flow, and overall debt service ability; and (ii) the value of any collateral;

(d) standards for the timely movement of loans to non-accrual status;

(e) written standards for when reappraisals and reevaluations must be conducted, including, but not limited to, when new funds are advanced or when changes in market conditions or the condition of the collateral occur;

(f) enhanced appraisal review procedures to ensure the quality of appraisals;

(g) standards for construction inspections by qualified independent parties;

and

(h) procedures for the timely and accurate identification of problem loans.

### **Loan Review Program**

6. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written program for strengthening internal review and grading of the Bank's loan portfolio by a qualified independent party or by staff that is independent of the Bank's lending function. The program shall, at a minimum, address, consider, and include:

(a) The scope and frequency of loan review;

(b) standards and criteria for assessing the credit quality of loans;

(c) application of loan grading standards and criteria to the loan portfolio, including procedures to re-evaluate loans in the event of material changes in the borrower's performance or value of the collateral; and

(d) controls to ensure the consistent adherence to the loan grading standards and criteria and the revised review program.

## **Asset Improvement**

7. The Bank shall not, directly or indirectly, extend, renew, or restructure any credit to or for the benefit of any borrower, including any related interest of the borrower, whose loans or other extensions of credit are criticized in the report of examination of the Bank conducted by the Reserve Bank that commenced on October 13, 2009 (the "Report of Examination") or in any subsequent report of examination, without the prior approval of a majority of the full board of directors or a designated committee thereof. The board of directors or its committee shall document in writing the reasons for the extension of credit, renewal, or restructuring, specifically certifying that: (i) the Bank's risk management policies and practices for loan workout activity are acceptable; (ii) the extension of credit is necessary to improve and protect the Bank's interest in the ultimate collection of the credit already granted and maximize its potential for collection; (iii) the extension of credit reflects prudent underwriting based on reasonable repayment terms and is adequately secured; and all necessary loan documentation has been properly and accurately prepared and filed; (iv) the Bank has performed a comprehensive credit analysis indicating that the borrower has the willingness and ability to repay the debt as supported by an adequate workout plan, as necessary; and (v) the board of directors or its designated committee reasonably believes that the extension of credit will not impair the Bank's interest in obtaining repayment of the already outstanding credit and that the extension of credit or renewal will be repaid according to its terms. The written certification shall be made a part of the minutes of the meetings of the board of directors or its committee, as appropriate, and a copy of the signed certification, together with the credit analysis and related information that was used in the determination, shall be retained by the Bank in the borrower's credit file for subsequent supervisory review. For purposes of this Agreement, the term "related interest" is defined as set

forth in section 215.2(n) of Regulation O of the Board of Governors of the Federal Reserve System (the “Board of Governors”) (12 C.F.R. § 215.2(n)).

8. (a) Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written plan designed to improve the Bank’s position through repayment, amortization, liquidation, additional collateral, or other means on each loan or other asset in excess of \$250,000, including other real estate owned (“OREO”), that: (i) is past due as to principal or interest more than 90 days as of the date of this Agreement; (ii) is on the Bank’s problem loan list; or (iii) was adversely classified in the Report of Examination.

(b) Within 30 days of the date that any additional loan or other asset in excess of \$250,000, including OREO, becomes past due as to principal or interest for more than 90 days, is on the Bank’s problem loan list, or is adversely classified in any subsequent report of examination of the Bank, the Bank shall submit to the Reserve Bank and the Division an acceptable written plan to improve the Bank’s position on such loan or asset.

(c) Within 30 days after the end of each calendar quarter thereafter, the Bank shall submit a written progress report to the Reserve Bank and the Division to update each asset improvement plan, which shall include, at a minimum, the carrying value of the loan or other asset and changes in the nature and value of supporting collateral, along with a copy of the Bank’s current problem loan list, a list of all loan renewals and extensions without the full collection of interest in the last quarter, and past due/non-accrual report. Each asset improvement plan shall specifically include the following information: (i) origination date; (ii) specific original use of funds; (iii) renewal date(s); and (iv) specific reason for renewal and use of funds at each renewal date. “Origination date” shall be defined as the first date that the Bank advanced any funds to the borrower or related interest for the same purpose.

(d) Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division a report which lists every loan currently on the books of the Bank where the Bank has advanced any interest, including loans which provided for the advancement of interest at origination. This report shall include loan number, loan name, date of origination, and renewal date(s), if any, original principal amount, current principal amount, and the total amount of interest advanced since the origination date.

(e) Within 30 days after the end of each calendar quarter, the Bank shall provide a report, which lists all loans currently on the books of the Bank where any interest was advanced to the borrower or related interest of the borrower for the same purpose. This quarterly report shall include the loan number, loan name, date of origination and renewal date(s), if any, original principal amount, current principal amount and the total amount of interest advanced since the origination date.

#### **Allowance for Loan and Lease Losses**

9. (a) Within 10 days of this Agreement, the Bank shall eliminate from its books, by charge-off or collection, all assets or portions of assets classified “loss” in the Report of Examination that have not been previously collected in full or charged off. Thereafter, the Bank shall, within 30 days from the receipt of any federal or state report of examination, charge off all assets classified “loss” unless otherwise approved in writing by the Reserve Bank and the Division.

(b) Within 60 days of this Agreement, the Bank shall review and revise its ALLL methodology consistent with relevant supervisory guidance, including the Interagency Policy Statements on the Allowance for Loan and Lease Losses, dated July 2, 2001 (SR 01-17 (Sup)) and December 13, 2006 (SR 06-17), and the findings and recommendations regarding the



ALLL set forth in the Report of Examination, and submit a description of the revised methodology to the Reserve Bank and the Division. The revised ALLL methodology shall be designed to maintain an adequate ALLL and shall address, consider, and include, at a minimum, the reliability of the Bank's loan grading system, the volume of criticized loans, concentrations of credit, the current level of past due and nonperforming loans, past loan loss experience, evaluation of probable losses in the Bank's loan portfolio, including adversely classified loans, and the impact of market conditions on loan and collateral valuations and collectibility.

(c) Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written program for the maintenance of an adequate ALLL. The program shall include policies and procedures to ensure adherence to the revised ALLL methodology and provide for periodic reviews and updates to the ALLL methodology, as appropriate. The program shall also provide for a review of the ALLL by the board of directors on at least a quarterly calendar basis. Any deficiency found in the ALLL shall be remedied in the quarter it is discovered, prior to the filing of the Consolidated Reports of Condition and Income, by additional provisions. The board of directors shall maintain written documentation of its review, including the factors considered and conclusions reached by the Bank in determining the adequacy of the ALLL.

(d) During the term of this Agreement, the Bank shall submit to the Reserve Bank and the Division, within 30 days after the end of each calendar quarter, a written report regarding the board of directors' quarterly review of the ALLL and a description of any changes to the methodology used in determining the amount of ALLL for that quarter.

## Capital Plan

10. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written plan to maintain sufficient capital at the Bank. The plan shall, at a minimum, address, consider, and include the Bank's current and future capital requirements, including:

- (a) Compliance with the Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure and Tier 1 Leverage Measure, Appendices A and B of Regulation H of the Board of Governors (12 C.F.R. Part 208, App. A and B);
- (b) the volume of adversely classified assets;
- (c) the adequacy of the loan loss reserve;
- (d) any planned asset growth;
- (e) the anticipated level of retained earnings;
- (f) anticipated and contingent liquidity needs; and
- (g) the source and timing of additional funds to fulfill the future capital and loan loss reserve needs of the Bank.

11. The board of directors shall monitor and review the sufficiency of the Bank's capital on a monthly basis and shall: (i) notify the Reserve Bank and the Division, in writing, no more than 30 days after the end of any quarter in which the Bank's capital ratios (total risk-based, tier one risk-based, or leverage) fall below the plan's minimums; and (ii) submit simultaneously to the Reserve Bank and the Division an acceptable written plan that details the steps the Bank will take to increase its capital ratios above the plan's minimums.

## **Liquidity and Funds Management**

12. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written plan designed to improve management of the Bank's liquidity position and funds management practices. The plan shall, at a minimum, address, consider, and include:

(a) Measures to enhance the monitoring, measurement, and reporting of the Bank's liquidity to the board of directors;

(b) reduced reliance on wholesale funding, including a planned reduction in brokered deposits that details the Bank's current composition of brokered deposits by maturity and explains the means by which such deposits will be repaid at maturity; and

(c) specific liquidity targets and parameters to maintain sufficient liquidity to meet contractual obligations and unanticipated demands.

13. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable enhanced written contingency funding plan that, at a minimum, identifies available sources of liquidity and includes adverse scenario planning.

## **Earnings Plan and Budget**

14. (a) Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division a written business plan for the remainder of 2010 to improve the Bank's earnings and overall condition. The plan, at a minimum, shall provide for or describe:

(i) Goals and strategies for improving the Bank's earnings;

(ii) a realistic and comprehensive budget for the remainder of 2010, including income statement and balance sheet projections; and

(iii) a description of the operating assumptions that form the basis for,

and adequately support, major projected income, expense, and balance sheet components.

(b) Upon adoption, the Bank shall implement the business plan. Bank management shall report monthly to the Bank's board of directors on progress made in implementing the business plan.

(c) A business plan and budget for each calendar year subsequent to 2010 shall be submitted to the Reserve Bank and the Division at least 30 days prior to the beginning of that calendar year.

### **Dividends**

15. (a) The Bank shall not declare or pay any dividends without the prior written approval of the Reserve Bank, the Director of the Division of Banking Supervision and Regulation of the Board of Governors ("Director"), and the Division.

(b) All requests for prior approval shall be received at least 30 days prior to the proposed dividend declaration date. All requests shall contain, at a minimum, current and projected information, as appropriate, on the Bank's capital, asset quality, earnings and loan loss reserve needs; and identification of the sources of funds for the proposed payment. The Bank must also demonstrate that the requested declaration or payment of dividends is consistent with the Board of Governors' Policy Statement on the Payment of Cash Dividends by State Member Banks and Bank Holding Companies, dated November 14, 1985 (Federal Reserve Regulatory Service, 4-877 at page 4-323).

### **Compliance with Laws and Regulations**

16. (a) In appointing any new director or senior executive officer or changing the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position, the Bank shall comply with the notice provisions of section 32 of the

FDI Act (12 U.S.C. § 1831i) and Subpart H of Regulation Y of the Board of Governors (12 C.F.R. §§ 225.71 *et seq.*).

(b) The Bank shall comply with the restrictions on indemnification and severance payments of section 18(k) of the FDI Act (12 U.S.C. § 1828(k)) and Part 359 of the FDIC's regulations (12 C.F.R. Part 359).

17. The Bank shall immediately take all necessary steps to correct all violations of laws and regulations set forth in the Report of Examination, including, but not limited to, the provisions of Regulation O of the Board of Governors (12 C.F. R. Part 215). In addition, the board of directors shall take necessary steps to ensure the Bank's future compliance with all applicable laws and regulations.

#### **Compliance with the Agreement**

18. (a) Within 15 days of this Agreement, the board of director of the Bank shall appoint a compliance committee (the "Compliance Committee") to monitor and coordinate the Bank's compliance with the provisions of this Agreement. The Compliance Committee shall include a majority of outside directors who are not executive officers of the Bank, as defined in sections 215.2(e)(1) of Regulation O of the Board of Governors (12 C.F.R. § 215.2(e)(1)). At a minimum, the Compliance Committee shall meet at least monthly, keep detailed minutes of each meeting, and report its findings to the board of directors of the Bank.

(b) Within 30 days after the end of each calendar quarter following the date of this Agreement, the Bank shall submit to the Reserve Bank and the Division, as applicable, written progress reports detailing the form and manner of all actions taken to secure compliance with this Agreement and the results thereof.

## **Approval and Implementation of Plans, Programs, and Engagement Letter**

19. (a) The written plans, programs, and an engagement letter required by paragraphs 2(b), 4, 5, 6, 8(a), 8(b), 9(c), 10, 11, 12 and 13 of this Agreement shall be submitted to the Reserve Bank and the Division for review and approval. Acceptable plans, programs, and engagement letter shall be submitted within the time periods set forth in the Agreement. An independent consultant acceptable to the Reserve Bank shall be retained in the time period set forth in paragraph 2(a).

(b) Within 10 days of approval by the Reserve Bank and the Division, the Bank shall adopt the approved plans, programs, and engagement letter. Upon adoption, the Bank shall promptly implement the approved plans, programs, and engagement letter and thereafter fully comply with them.

(c) During the term of this Agreement, the approved plans, programs, and engagement letter shall not be amended or rescinded without the prior written approval of the Reserve Bank and the Division.

## **Communications**

20. All communications regarding this Agreement shall be sent to:

- (a) Ms. Susan E. Zubradt  
Vice President  
Federal Reserve Bank of Kansas City  
1 Memorial Drive  
Kansas City, Missouri 64198
- (b) Mr. Steven A. Strunk  
Commissioner  
Colorado Division of Banking  
1560 Broadway, Suite 975  
Denver, Colorado 80202

(c) Mr. Fred J. Bauer  
President  
Farmers Bank  
119 First Street  
Ault, Colorado 80610

**Miscellaneous**

21. Notwithstanding any provision of this Agreement, the Reserve Bank and the Division may, in their sole discretion, grant written extensions of time to the Bank to comply with any provision of this Agreement.

22. The provisions of this Agreement shall be binding upon the Bank, and its institution-affiliated parties, in their capacities as such, and their successors and assigns.

23. Each provision of this Agreement shall remain effective and enforceable as to the Bank until jointly stayed, modified, terminated, or suspended in writing by the Reserve Bank and the Division.

24. The provisions of this Agreement shall not bar, estop, or otherwise prevent the Board of Governors, the Reserve Bank, the Division, or any other federal or state agency from taking any other action affecting the Bank, or any of its current or former institution-affiliated parties and its successors and assigns.

25. Pursuant to section 50 of the FDI Act (12 U.S.C. § 1831aa), this Agreement is enforceable by the Board of Governors under section 8 of the FDI Act (12 U.S.C. § 1818).

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the 19<sup>th</sup> day of May, 2010.

FARMERS BANK

FEDERAL RESERVE BANK  
OF KANSAS CITY

By: /s/ Fred J. Bauer  
Fred J. Bauer  
President

By: /s/ Susan E. Zubradt  
Susan E. Zubradt  
Vice President

COLORADO DIVISION OF BANKING

By: /s/ Steven A. Strunk  
Steven A. Strunk  
Commissioner