

#2001-114

AGREEMENT BY AND BETWEEN

Ballston Spa National Bank

Ballston Spa, New York

and

The Office of the Comptroller of the Currency

Ballston Spa National Bank, Ballston Spa, New York (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, dated February 26, 2001 (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 pursuant to this Agreement shall be forwarded to the:

Assistant Deputy Comptroller
Upstate New York Field Office
231 Salina Meadows Parkway, Suite 105
Syracuse, New York 13212

ARTICLE II

LOAN PORTFOLIO MANAGEMENT

(1) Within (60) days, the Board shall appoint a new, capable Senior Loan Officer who shall be vested with sufficient executive authority to fulfill the duties and responsibilities of the position and ensure safe and sound operation of the bank.

(2) The Board shall, within 60 days of the employment of a Senior Lending Officer, develop, implement, and thereafter ensure Bank adherence to a written program to improve the Bank's loan portfolio management and correct each deficiency cited in the February 26, 2001 Report of Examination and any subsequent Report of Examination. The program shall be designed in light of comments on maintaining an effective loan function found in the Loan

Portfolio Management booklet, dated April 1998, of the Comptroller's Handbook. The program shall include, but not be limited to:

- (a) procedures to ensure adequate controls over accounts receivable, inventory financing and floor plan lending;
- (b) procedures to ensure satisfactory and perfected collateral documentation, including ongoing monitoring of lien perfection;
- (c) 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;
- (d) procedures to ensure conformance with loan approval requirements, including ongoing monitoring of financial information, collateral valuation and loan covenants;
- (e) guidelines discussed in OCC Bulletin 2001-6, Subprime Lending.
- (f) a system to track, analyze and report (monthly) exceptions for both retail and commercial loans;
- (g) a system to track, analyze, and report (monthly) retail loan extensions, deferrals and reworkings;
- (h) establish an effective and on-going internal problem loan identification system to review the Bank's loan and lease portfolios to assure the timely identification and categorization of problem credits;
- (i) procedures to ensure the accuracy of internal management information systems; and

- (j) 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.

(3) Upon completion, a copy of the program shall be forwarded to the Assistant Deputy Comptroller.

(4) Beginning no later than September 30, 2001, and on a monthly basis, management will provide the Board with written reports including, at a minimum, the following information:

- (a) the identification, type, rating, and amount of problem loans and leases, which should include a comparison to prior periods;
- (b) the identification and amount of delinquent loans and leases, which should include a comparison to prior periods and a peer group(s);
- (c) credit and collateral documentation exceptions, which should include a comparison to prior periods; and
- (d) 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, which should include a comparison to prior periods.

(5) The Board shall evaluate all internal loan and lease review reports and shall ensure that immediate, adequate, and continuing remedial action, if appropriate, is taken upon all findings noted in the reports.

ARTICLE III

PARTICIPATIONS PURCHASED

(1) The Bank may grant, purchase, assume or acquire in any manner, directly or indirectly, or as a fiduciary or nominee, any loan, loan participation, loan obligation or other asset, as long as such grant, purchase, assumption, or acquisition is consistent with safe and sound banking practices, the guidelines set forth in Banking Circular 181 (Revised), dated August 2, 1984, and the requirements of 12 C.F.R. Part 34.

ARTICLE IV

EXTERNAL LOAN REVIEW

(1) Within **120** days, the Board shall develop, implement, and thereafter ensure Bank adherence to a written program providing for an independent review of problem loans and leases in the Bank's loan and lease portfolios for the purpose of monitoring portfolio quality and trends, on at least an annual basis. At a minimum the program shall provide for an independent reviewer's assessment of the Bank's:

- (a) monitoring systems for early problem loan identification to assure the timely identification and rating of loans and leases based on lending officer submissions;
- (b) statistical records that serve as a basis for identifying sources of problem loans and leases by industry, size, collateral, division, group, indirect dealer, and individual lending officer;
- (c) system for monitoring previously charged-off assets and their recovery potential;
- (d) system for monitoring compliance with the Bank's lending policies and laws, rules, and regulations pertaining to the Bank's lending function; and

- (e) system for monitoring the adequacy of credit and collateral documentation.

(2) The program shall provide for a written report to be filed with the Board after each review. 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 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 Assistant Deputy Comptroller upon implementation.

(4) The Board shall evaluate all external loan and lease review reports and shall ensure that immediate, adequate, and continuing remedial action, if appropriate, is taken upon all findings noted in the reports.

ARTICLE V

ALLOWANCE FOR LOAN AND LEASE LOSSES

(1) Within 60 days of the employment of a Senior Loan Officer, the Board shall review the adequacy of the Bank's Allowance for Loan and Lease Losses (Allowance) and shall establish a program for the maintenance of an adequate Allowance and correct each deficiency cited in the February 26, 2001 Report of Examination or any subsequent Report of Examination. This review and program shall be designed in light of the comments on maintaining a proper Allowance found in the Allowance for Loan and Lease Losses booklet, dated June 1996, of the Comptroller's Handbook, and shall focus particular attention on the following factors not currently part of management's Allowance methodology:

- (a) an estimate of inherent loss exposure on each significant credit, which must include an analysis of related debt to determine if repayment is in any way negatively impacted;
- (b) loan loss experience, which must include a separate analysis of subprime consumer loans;
- (c) trends of delinquent and nonaccrual loans, which must include a separate analysis of subprime consumer loans;
- (d) compliance with OCC Bulletin 2000-20, Retail Classification and Account Management Policy, and include any classified retail loans in the quarterly analysis;
- (e) results of an analysis of qualitative factors to include the issues identified in the most recent Report of Examination and their effect on each factor considered; and

- (f) historical loss experience of classified and criticized loans analyzed separately to determine a historical loss factor for each category, which should include a reasonable documented explanation for any deviation from the results of this analysis.

(2) The program shall provide for a review of the Allowance by the Board each calendar quarter. Any deficiency in the Allowance shall be remedied in the quarter it is discovered, prior to the filing of the Consolidated Reports of Condition and Income, by additional provisions from earnings. Written documentation shall be maintained indicating the factors considered and conclusions reached by the Board in determining the adequacy of the Allowance.

(3) A copy of the Board's program shall be submitted to the Assistant Deputy Comptroller for review and approval.

ARTICLE VI

INTERNAL AUDIT

(1) Within **180** days, the Board shall adopt, implement, and thereafter ensure Bank adherence to an independent, internal audit program and correct each deficiency cited in the February 26, 2001 Report of Examination or any subsequent Report of Examination. The Board shall implement an 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, problem loan identification and classification, and Information Technology Systems internal controls;

- (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 scope, frequency, and 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 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, which 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) The Board shall ensure internal auditors create an appropriate audit trail containing documents to support all procedures performed and conclusions documented in audit reports.

(6) 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.

(7) 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.

(8) Upon adoption, a copy of the internal audit program shall be promptly submitted to the Assistant Deputy Comptroller.

ARTICLE VII

INFORMATION TECHNOLOGY SYSTEMS DEFICIENCIES

(1) The Bank shall immediately take all steps necessary to correct each deficiency cited in the November 27, 2000 Information Technology Systems (ITS) Report of Examination or any subsequent Report of Examination.

(2) Within **60** days, the Bank shall develop an effective and independent internal ITS audit program. At a minimum, the ITS audit program shall be performed by an independent and qualified individual, and include fundamental elements of a sound audit program as described in the Federal Financial Institutions Examination Council's 1996 Information Systems Examination Handbook.

(3) Within **60** days, the Board shall appoint a Security Officer familiar with ITS operations. The Security Officer shall be responsible for reviewing and ensuring appropriate data security of the Bank.

(4) Within **90** days, the Bank shall ensure that the data processing manager has the necessary staff to effectively manage risks in the ITS area.

(5) Within **90** days, the Bank shall implement effective ITS security and operations procedures as described in the Federal Financial Institutions Examination Council's 1996

Information Systems Examination Handbook, and Banking Circular Number 229, dated May 31, 1988.

ARTICLE VIII

PROGRESS REPORTING - QUARTERLY

(1) The Board shall submit quarterly progress reports to the Assistant Deputy Comptroller, Upstate New York Field Office, 231 Salina Meadows Parkway, Suite 105, Syracuse, New York 13212. These reports shall set forth in detail:

- (a) actions taken to comply with each Article of the Formal Agreement;
- (b) results of those actions; and
- (c) a description of the actions needed to achieve full compliance with each Article of this Formal Agreement.

(2) The progress reports should also include any actions initiated by the Board and the Bank pursuant to the criticisms and comments in the Report of Examination or in any future Report of Examination.

The first progress report shall be submitted for the period ending September 30, 2001 and will be due within **10** days of that date. Thereafter, progress reports will be due within **10** days after the quarter end.

ARTICLE IX

CLOSING

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

(2) It is expressly and clearly understood that if, at any time, the Comptroller deems it appropriate in fulfilling the responsibilities placed upon him 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.

(3) 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 Assistant Deputy Comptroller for good cause upon written application by the Board.

(4) 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.

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

/s/ Roger L. Graham

June 28, 2001

Roger L. Graham
Assistant Deputy Comptroller
Comptroller of the Currency

June 28, 2001

IN 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.

Signed	6/28/01
_____ William D. Bennison	_____ Date
Signed	6/28/01
_____ Thomas Gallogly	_____ Date
Signed	6/28/01
_____ J. Peter Hansen	_____ Date
Signed	6/28/01
_____ Ronald G. Harrington	_____ Date
Signed	6/28/01
_____ William J. McNeary	_____ Date
Signed	6-28-01
_____ Timothy J. Provost	_____ Date
Signed	7/2/01
_____ Douglas P. Seholm	_____ Date
Signed	6/28/01
_____ Stephen E. Strader	_____ Date
Signed	June 28, 2001
_____ Robert E. VanVranken	_____ Date
Signed	6/28/01
_____ James Whelden	_____ Date

