

FORMAL AGREEMENT

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

First National Bank, Bullard, 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 (ROE) dated June 30, 2001.

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.

This Agreement supercedes the Memorandum of Understanding dated April 4, 2000 (MOU) which is hereby rescinded.

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 "final order" within the meaning of 12 U.S.C. § 1818(u).

- (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:

Marshall W. Mitchell
Assistant Deputy Comptroller
Longview Field Office
1800 West Loop 281, Suite 306
Longview, Texas 75604 2516

ARTICLE II -- CAPITAL PLAN AND HIGHER MINIMUMS

- (1) The Bank shall achieve by March 31, 2002 and thereafter maintain the following capital levels (as defined in 12 C.F.R. Part 3):

(a) Tier 1 capital at least equal to eight percent (8%) of adjusted total assets.

- (2) Within thirty (30) days, the Board shall develop, implement, and thereafter ensure Bank adherence to a three-year capital program. The program shall include:

(a) specific plans for the maintenance of adequate capital that may in no event be less than the requirements of paragraph (1);

(b) projections for growth and capital requirements based upon a detailed analysis of the Bank's assets, liabilities, earnings, fixed assets, and off-balance sheet activities;

(c) projections of the sources and timing of additional capital to meet the Bank's current and future needs;

(d) the primary source(s) from which the Bank will strengthen its capital structure to meet the Bank's needs;

(e) contingency plans that identify alternative methods should the primary source(s) under (d) above not be available; and

(f) a dividend policy that permits the declaration of a dividend only:

(i) when the Bank is in compliance with its approved capital program;

(ii) when the Bank is in compliance with 12 U.S.C. §§ 56 and 60; and

(iii) with the prior written approval of the Assistant Deputy Comptroller.

- (3) Upon completion, the Bank's capital program shall be submitted to the Assistant Deputy Comptroller for approval. Upon approval by the Assistant Deputy Comptroller, the

Bank shall implement and adhere to the capital program. The Board shall review and update the Bank's capital program on an annual basis, or more frequently if necessary. Copies of the reviews and updates shall be submitted to the Assistant Deputy Comptroller.

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

ARTICLE III -- COMPLIANCE COMMITTEE

(1) Within fifteen (15) days, the Board shall appoint a Compliance Committee of at least three (3) directors, of which no more than one (1) shall be employees of the Bank or any of its affiliates (as the term "affiliate" is defined in 12 U.S.C. §371c(b)(1)), or a family member of any such person. Upon appointment, the names of the members of the Compliance Committee shall be submitted in writing to the Assistant Deputy Comptroller. The Compliance Committee shall be responsible for monitoring and coordinating the Bank's adherence to the provisions of this Agreement.

(2) The Compliance Committee shall meet at least monthly.

(3) Within thirty (30) days of the appointment of the Committee and every thirty (30) days thereafter, the Compliance Committee shall submit a written progress report to the Board setting forth in detail:

- (a) actions taken to comply with each Article of this Formal Agreement; and
- (b) the results of those actions.

ARTICLE IV -- LOAN PORTFOLIO MANAGEMENT

(1) The Board shall immediately ensure Bank adherence to the 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 by requiring the following:
 - (i) loan worksheets on all borrowers that clearly detail a full description of the collateral, its value, the source of the valuation, and the date the value was determined;

- (ii) adequate information obtained to determine the value of any accounts or notes receivables held as collateral, including account receivable agings;
 - (iii) timely inspections performed on all asset dependent loans, such as vehicle floor plans and livestock loans; and
 - (iv) adequate evaluations documented on all real estate loans, including those loans under the statutory threshold to require certified appraisals.
- (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 which include requiring:
 - (i) trend and financial ratio analysis using a spread of financial statements on commercial borrowers with aggregate debt exceeding one hundred thousand dollars (\$100,000);
 - (ii) financial statement reviews that include documenting observed trends and questions on all other borrowers; and
 - (iii) cash flow analysis on all borrowers, regardless of size, including all debt service requirements.
- (c) procedures to ensure financial information is obtained and analyzed throughout the term of the credit;
- (d) procedures to ensure conformance with loan approval requirements;
- (e) a system to track and analyze exceptions;
- (f) procedures to ensure conformance with Call Report instructions;
- (g) procedures to ensure the accuracy of internal management information systems; and
- (h) procedures to track and analyze concentrations of credit, significant economic factors, and general conditions and their impact on the credit quality of the Bank's loan and lease portfolios.
- (i) procedures to ensure that Board approval is required prior to funding any loan that does not comply with Loan Policy or established underwriting standards.

- (j) procedures to ensure that Board approval is required prior to the funding of any loan that is outside the lending authority of bank officers.
- (2) If any changes are made to the loan portfolio management program, a copy of the program shall be forwarded to the Assistant Deputy Comptroller.
- (3) Immediately the Board shall ensure adherence to the bank's systems which provide for effective monitoring of:
 - (a) early problem loan identification to assure the timely identification and rating of loans and leases based on lending officer submissions;
 - (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.
- (4) The Board shall ensure the Bank has processes, personnel, and control systems to ensure adherence to the program and systems developed pursuant to this Article.

ARTICLE V -- DIRECT AND INDIRECT AUTOMOBILE LENDING

- (1) Within thirty (30) days, the Board shall develop and adopt revised direct and indirect automobile lending policies, procedures and guidelines which include at a minimum:
 - (a) a description of acceptable types of direct and indirect loans;
 - (b) a provision that current and satisfactory credit information will be obtained on each borrower;
 - (c) underwriting guidelines for minimal acceptable debt to income ratios;
 - (d) requirements for borrower income verification;
 - (e) loan terms based on the anticipated source of repayment, and the useful life of the collateral;
 - (f) a maximum ratio of loan value (including any add-ons such as credit life, credit disability, force placed insurance and service contracts) to asset value;
 - (g) collection procedures, to include follow-up efforts that are systematically and progressively stronger;

- (h) charge-off of all direct and indirect automobile loans which are past due one hundred twenty (120) days or more;
- (i) a prohibition on the renewal or extension of any loans without the written approval of the president, who shall review the borrower's past repayment history and current ability to repay and then document how the extension will enhance the collectibility of the credit;
- (j) disposition policies and procedures for repossessed automobiles;
- (k) a list of Board approved indirect dealers along with limitations on aggregate outstanding loans based on individual dealers;
- (l) guidelines and limitations on concentrations of credit;
- (m) procedures to ensure that Board approval is required prior to funding any insider-related loan that does not comply with Loan Policy or established underwriting standards;
- (n) guidelines to insure that the Bank's direct and indirect automobile loans are written in compliance with all applicable laws, rules and regulations; and
- (o) systems to monitor past dues and losses by indirect dealer relationships.

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

(3) Upon completion, the Bank's Direct and Indirect Automobile Lending Policy plan shall be submitted to the Assistant Deputy Comptroller for approval.

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 Report of Examination, by internal or external loan review, or in any list provided to management by the National Bank Examiners during any examination.

(2) Immediately, the Board shall ensure Bank adherence to the written program designed to eliminate the basis of criticism of assets criticized in the ROE, in any subsequent Report 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) The Board shall ensure that the Bank has processes, personnel, and control systems to ensure implementation of and adherence to the program developed pursuant to this Article.

(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 fifty thousand dollars (\$50,000);
- (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 Assistant Deputy Comptroller 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 one hundred thousand dollars (\$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 -- AUDIT PROGRAM

(1) The Board shall immediately implement and thereafter ensure Bank adherence to an independent, internal audit program developed in compliance with the MOU. This program must be 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; including a review of internal control systems; 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 Bank has processes, personnel, and control systems to ensure implementation of and adherence to the program developed pursuant to this Article.

(4) 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.

(5) 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.

(6) All audit reports shall be in writing. The Board shall ensure that timely 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) If any changes are subsequently made to the audit program, a copy of the revised program shall be promptly submitted to the Assistant Deputy Comptroller.

ARTICLE VIII -- INTERNAL CONTROL SYSTEM

(1) The Board shall immediately implement, and thereafter ensure Bank adherence to, the internal control system developed in compliance with the MOU.

(2) A copy of the written review of internal controls created during the Bank's internal or external audits and the actions taken shall promptly be sent to the Assistant Deputy Comptroller.

ARTICLE IX -- INSIDER BUSINESS TRANSACTIONS

(1) The Bank may enter into a Business Transaction with an Insider only if the Business Transaction is:

- (a) made in compliance with Board approved loan underwriting guidelines;
- (b) 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) made, in the absence of comparable transactions, on reasonable commercial terms entered into in good faith and reflecting comparable service fees payable to similarly situated service providers (for example, professional service contracts);
- (d) 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
- (e) approved in advance by a vote of the Board, with any interested Insider abstaining from voting and participating directly or indirectly in the deliberations regarding the approval.

- (2) "Insider" shall have the same meaning as set forth in 12 C.F.R. § 215.2.

ARTICLE X -- VIOLATIONS OF LAW

(1) The Board shall immediately take all necessary steps to ensure that Bank management corrects each violation of law, rule or regulation cited in the ROE and in any subsequent Report of Examination.

(2) The Board shall immediately implement and thereafter ensure Bank adherence to specific procedures to prevent future violations as cited in the ROE and shall implement and ensure Bank adherence to general procedures addressing compliance management which incorporate internal control systems and education of employees regarding laws, rules and regulations applicable to their areas of responsibility.

(3) Within ninety (90) days of receipt of any subsequent Report of Examination which cites violations of law, rule, or regulation, the Board shall adopt, implement, and thereafter ensure Bank adherence to specific procedures to prevent future violations as cited in the ROE and shall adopt, implement, and ensure Bank adherence to general procedures

addressing compliance management which incorporate internal control systems and education of employees regarding laws, rules and regulations applicable to their areas of responsibility.

(4) Upon revision of this program, a copy of these procedures shall be promptly forwarded to the Assistant Deputy Comptroller.

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

ARTICLE XI -- PROGRESS REPORTING - QUARTERLY

(1) The Board shall submit quarterly progress reports to the Assistant Deputy Comptroller, Longview Field Office (Assistant Deputy Comptroller). These reports shall set forth in detail:

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

(3) The first progress report shall be submitted for the period ending October 31, 2001 and will be due within fifteen (15) days of that date. Thereafter, progress reports will be due within fifteen (15) days after the quarter end.

ARTICLE XII -- 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/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.

(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/her hand on behalf of the Comptroller.

/s/ Marshall W. Mitchell

9/18/01

Marshall W. Mitchell
Assistant Deputy Comptroller
Longview Field Office

Date

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.

Signed

9/18/01

Billy Bacon

Date

Signed

9/18/01

Terry Cowan

Date

Signed

9/18/01

Wallace Emerson

Date

Signed

9/18/01

Richard Brooks Hardee

Date

Signed

9/18/01

Tom Roper

Date