

#2002-52

**UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY**

In the Matter of:)
Harbor Bank, N.A.)
Gig Harbor, Washington)

CONSENT ORDER

The Comptroller of the Currency of the United States of America (“Comptroller”), through his National Bank Examiner, has examined Harbor Bank, N.A., Gig Harbor, Washington (“Bank”), and his findings are contained in the Report of Examination, dated March 4, 2002 (“ROE”).

The Bank, by and through its duly elected and acting Board of Directors (“Board”), has executed a “Stipulation and Consent to the Issuance of a Consent Order,” dated May 10, 2002, that is accepted by the Comptroller. By this Stipulation and Consent, that is incorporated by reference, the Bank has consented to the issuance of this Consent Order (“Order”) by the Comptroller.

Pursuant to the authority vested in him by the Federal Deposit Insurance Act, as amended, 12 U.S.C. § 1818, the Comptroller hereby orders that:

Article I

COMPLIANCE COMMITTEE

(1) The Board shall have a Compliance Committee of at least three (3) directors, of which none 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. The name of any

newly-appointed member 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 Order.

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

(3) On a quarterly basis, 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 Order; and
- (b) the results of those actions.

(4) The Board shall forward a copy of the Compliance Committee's report signed by the committee chairperson with any additional comments by the Board, to the Assistant Deputy Comptroller.

Article II

CREDIT ADMINISTRATION

(1) Within thirty (30) days, the Board shall develop, implement, and thereafter ensure Bank adherence to a written program to reduce credit risk in the Bank. The program shall include, but not be limited to:

- (a) procedures to strengthen credit underwriting, particularly in the commercial and commercial real estate portfolios;
- (b) procedures to prepare problem loan status reports, updated on a monthly basis, which include:
 - (i) identified trigger points for loan grade changes and corrective action;
 - (ii) accrual status and triggers for placing loan on nonaccrual;

- (iii) full collateral analysis;
 - (iv) progress to date on correcting deficiencies;
 - (v) Bank's action plan going forward; and
 - (vi) assigned responsibility and accountability.
- (c) procedures to ensure loan officer accountability and responsibility for credit quality and risk rating accuracy;
 - (d) procedures and training to ensure an accurate and timely account officer-driven risk rating system;
 - (e) procedures to ensure an effective problem loan identification system for deteriorating pass credits;
 - (f) procedures to ensure satisfactory and perfected collateral documentation;
 - (g) procedures for obtaining and analyzing current and satisfactory credit information on term loans of \$100,000 or greater, at least on an annual basis; and
 - (h) a system to track credit, collateral, and policy exceptions.

(2) 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; and
 - (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.
- (3) The Board shall submit a copy of the program 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

INDEPENDENT LOAN REVIEW

- (1) The Board shall immediately 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) Not less than quarterly, the Board shall obtain an independent loan review report from its designated person/firm to identify credit risk, additional losses, or credit and collateral exceptions.
- (3) The Board shall incorporate the findings of the independent loan review into its analysis of the Allowance for Loan and Lease Losses (“ALLL”).
- (4) The Board shall establish an effective, independent and ongoing loan review system to review, at least annually, 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 the Comptroller's Handbook Rating Credit Risk. 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

Article IV

OVERDRAFT POLICY

(1) The Board shall ensure Bank adherence to a written policy concerning the extension of overdrafts that shall include, at a minimum:

- (a) conditions and circumstances under which overdrafts will be charged off;

- (b) approval authorities;
 - (c) assignment of accountability;
 - (d) conditions and circumstances under which overdrafts will be allowed, taking into consideration the requirements of 12 U.S.C. § 375b;
 - (e) charges that will be levied against depositors using overdrafts; and
 - (f) conditions and circumstances under which overdrafts will be permitted to principal shareholders or the related interests (as that term is defined in 12 C.F.R. Part 215) of executive officers, directors or principal shareholders.
- (2) The Board shall approve any exceptions to the charge-off policy.
- (3) 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.

Article V

CREDIT AND COLLATERAL EXCEPTIONS

(1) Within thirty (30) days, the Board shall obtain current and satisfactory credit information on all loans lacking such information, including those listed in the ROE, in any subsequent Report of Examination, in any internal or external loan review, or in any listings of loans lacking such information provided to management by the National Bank Examiners at the conclusion of an examination.

(2) Within thirty (30) days, the Board shall ensure proper collateral documentation is maintained on all loans and correct each collateral exception listed in the ROE, in any subsequent Report of Examination, in any internal or external loan review, or in any listings of

loans lacking such information provided to management by the National Bank Examiners at the conclusion of an examination.

(3) The Board shall improve current risk monitoring practices of exceptions by establishing the following:

- (a) a tickler system to identify and track credit and collateral documentation exceptions;
- (b) risk limits on exceptions in the portfolio based on the number of loans and/or the dollar exposure of loans with exceptions; and
- (c) accountability for corrective action on exceptions.

(4) The Board shall improve risk monitoring practices of credit and collateral exceptions by obtaining monthly reports from management that identifies the following:

- (a) list of individual credit exceptions; and
- (b) management's progress at correcting deficiencies.

Article VI

REAL ESTATE APPRAISAL PROGRAM

(1) The Board shall immediately take all necessary steps to ensure that management corrects each of the violations of 12 C.F.R. Part 34 identified in the Report of Examination dated March 4, 2002.

(2) The Bank shall immediately implement and adhere to an effective written real estate appraisal policy that conforms with 12 C.F.R. Part 34 and the Interagency Appraisal and Evaluation Guidelines. At a minimum, the policy should:

- (a) establish procedures to evaluate and monitor the ongoing performance of individuals who perform appraisals and evaluations;
- (b) provide for the independence of the person performing the appraisals or evaluations;
- (c) identify the appropriate appraisal for various lending transactions;
- (d) establish criteria for the contents of evaluations performed pursuant to 12 C.F.R. § 34.43(b);
- (e) provide for the receipt of the appraisal or evaluation report in a timely manner to facilitate the underwriting decision; and
- (f) establish internal controls that promote compliance with these program standards.

(3) Within ninety (90) days, the Board and applicable lending staff shall receive training regarding the requirements of 12 C.F.R. Part 34.

Article VII

CAPITAL PLAN AND HIGHER MINIMUMS

(1) The Bank shall achieve by September 30, 2002 and thereafter maintain the following capital levels (as defined in 12 C.F.R. Part 3):

- (a) Total risk-based capital at least equal to 12% of risk-weighted assets; and
- (b) Tier 1 risk-based capital at least equal to 10% of risk-weighted assets.

(2) The requirement in this Order to meet and maintain a specific capital level means that the Bank may not be deemed to be “well capitalized” for purposes of 12 U.S.C. § 1831o and 12 C.F.R. Part 6 pursuant to 12 C.F.R. § 6.4(b)(1)(iv).

(3) Within forty-five (45) 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.

(4) 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.

(5) The Bank shall restrict asset growth to 5% until the capital plan submitted is approved by the Assistant Deputy Comptroller.

(6) 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 VIII

CONTINGENCY PLAN

(1) If the Bank fails to achieve compliance with any Article in this Order, or any deadline or requirement specified in any plan required to be submitted pursuant to this Order, it shall submit a Contingency Plan to the Assistant Deputy Comptroller within fifteen (15) days of receiving notice from the Assistant Deputy Comptroller that it is in noncompliance with the Order.

(2) If the OCC determines, in its sole judgment, that: (a) it objects to the Contingency Plan, and the Bank is unable to satisfactorily amend the Contingency Plan or resolve the OCC's supervisory objections; or (b) after receipt of the OCC's written determination of no supervisory objection to the Contingency Plan, the OCC determines, in its sole judgment, that the Contingency Plan has failed to achieve its stated objective, then upon receiving notice of that fact from the OCC, the Bank shall develop and shall submit to the OCC for its review and prior determination of no supervisory objection a Plan of Resolution, which shall detail the Board's proposal to sell or merge the Bank, or liquidate the Bank at no cost or loss to the Federal Deposit Insurance Corporation and in conformance with 12 U.S.C. § 181.

(3) The Plan or Resolution shall be submitted to the Assistant Deputy Comptroller no later than sixty (60) days after the receipt of the notice from the OCC as set forth in paragraph (2) of this Article.

(4) After the Assistant Deputy Comptroller has advised the Bank that she does not take supervisory objection to the Plan of Resolution, the Board shall immediately implement, and shall thereafter ensure adherence to, the terms of the Plan of Resolution. The OCC may, in its sole discretion, deem failure to submit to a timely, acceptable Plan of Resolution to be a violation of this Order.

Article IX

CLOSING

(1) Although the Board is by this Order required to submit certain proposed actions and programs for the review or approval of the Assistant Deputy Comptroller, 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 Order shall in any way inhibit, estop, bar or otherwise prevent the Comptroller from so doing.

(3) Any time limitations imposed by this Order shall begin to run from the effective date of this Order. Such time limitations may be extended in writing by the Assistant Deputy Comptroller for good cause upon written application by the Board.

(4) The provisions of this Order are effective upon issuance of this Order by the Comptroller, through his authorized representative whose hand appears below, and shall remain

effective and enforceable, except to the extent that, and until such time as, any provisions of this Order shall have been amended, suspended, waived, or terminated in writing by the Comptroller, or his designated representative.

(5) This Order is intended to be, and shall be construed to be, a final order issued pursuant to 12 U.S.C. § 1818(b), 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(i), 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 Order, 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.

(6) In each instance in this Order 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: (i) 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 Order; (ii) require the timely reporting by Bank management of such actions directed by the Board to be taken under the terms of this Order; (iii) follow-up on any non-compliance with such actions in a timely and

appropriate manner; and (iv) require corrective action be taken in a timely manner of any non-compliance with such actions.

IT IS SO ORDERED, this 10th day of May 2002.

/s/ Nancy E. Wilson

5-10-02

Nancy E. Wilson
Assistant Deputy Comptroller
Seattle Field Office

Date

**UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY**

In the Matter of:)
Harbor Bank, N.A.)
Gig Harbor, Washington)

**STIPULATION AND CONSENT TO THE ISSUANCE
OF A CONSENT ORDER**

The Comptroller of the Currency of the United States of America (“Comptroller”) has initiated cease and desist proceedings against Harbor Bank, N.A., Gig Harbor, Washington (“Bank”) pursuant to 12 U.S.C. § 1818(b).

The Bank, in the interest of compliance and cooperation, consents to the issuance of a Consent Order, dated May 10, 2002 (“Order”);

In consideration of the above premises, the Comptroller, through his authorized representative, and the Bank, through its duly elected and acting Board of Directors, hereby stipulate and agree to the following:

Article I

JURISDICTION

(1) The Bank is a national banking association chartered and examined by the Comptroller pursuant to the National Bank Act of 1864, as amended, 12 U.S.C. § 1 *et seq.*

(2) The Comptroller is “the appropriate Federal banking agency” regarding the Bank pursuant to 12 U.S.C. §§ 1813(q) and 1818(b).

(3) The Bank is an “insured depository institution” within the meaning of 12 U.S.C. § 1818(b)(1).

Article II

AGREEMENT

(1) The Bank, without admitting or denying any wrongdoing, hereby consents and agrees to the issuance of the Order by the Comptroller. The Bank further agrees that said Order shall be deemed an “order issued with the consent of the depository institution” as defined in 12 U.S.C. § 1818(h)(2), and consents and agrees that said Order shall become effective upon its issuance and shall be fully enforceable by the Comptroller under the provisions of 12 U.S.C. § 1818(i).

Article III

WAIVERS

(1) The Bank, by signing this Stipulation and Consent, hereby waives:

- (a) the issuance of a Notice of Charges pursuant to 12 U.S.C. § 1818(b);
- (b) any and all procedural rights available in connection with the issuance of the Order;
- (c) all rights to seek any type of administrative or judicial review of the Order; and
- (d) any and all rights to challenge or contest the validity of the Order.

Article IV

OTHER ACTION

(1) The Bank agrees that the provisions of this Stipulation and Consent shall not inhibit, estop, bar, or otherwise prevent the Comptroller from taking any other action affecting the Bank

if, at any time, he deems it appropriate to do so to fulfill the responsibilities placed upon him by the several laws of the United States of America.

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

/s/ Nancy E. Wilson
Nancy E. Wilson
Assistant Deputy Comptroller
Seattle Field Office

5-10-02
Date

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 Phillip Arenson	05-17-02 Date
Signed Michael Brown	05-10-02 Date
Rich Emery	Date
Signed Jon Kvinsland	05-10-02 Date
Signed Elizabeth Perrow	05-10-02 Date
Keith Petteys	Date
Signed James Tallman	05-10-02 Date
Signed Stanley Stearns	5-10-02 Date