

AGREEMENT BY AND BETWEEN  
The Karnes County National Bank of Karnes City  
Karnes City, Texas  
and  
The Comptroller of the Currency

The Karnes County National Bank of Karnes City, Karnes City, 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 has found unsafe and unsound banking practices including, but not limited to: Loan Portfolio Management, Problem Asset Management, Staffing, Consumer Compliance Oversight, and Audit.

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) This Agreement shall cause the Bank to be designated as in “troubled condition,” as set forth in 12 C.F.R. § 5.51(c)(6), unless otherwise informed in writing by the Comptroller. In addition, this Agreement shall cause the Bank not to be designated as an “eligible bank” for purposes of 12 C.F.R. § 5.3(g), unless otherwise informed in writing by the Comptroller.

(6) 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  
San Antonio Field Office  
10001 Reunion Place, Suite 250  
San Antonio, Texas 78216

## ARTICLE II

### PROGRESS REPORTING - QUARTERLY

(1) The Board shall submit quarterly progress reports to the Assistant Deputy Comptroller.

These reports shall set forth in detail:

- (a) actions taken since the prior progress report 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 shall 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 March 31, 2017 and will be due within ten (10) days of that date. Thereafter, progress reports will be due within ten (10) days after the quarter end.

## ARTICLE III

### LOAN PORTFOLIO MANAGEMENT

(1) The Board shall, within sixty (60) days, develop, implement, and thereafter ensure Bank adherence to a written program to improve the Bank's loan portfolio management. The program shall include, but not be limited to:

- (a) policies and/or procedures to ensure sufficient staff to support the Bank's lending function;
- (b) policies and/or procedures to ensure satisfactory and perfected collateral documentation;
- (c) policies and/or 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) policies and/or procedures to ensure conformance with loan approval requirements;
- (e) a system to track, analyze, and remedy credit, collateral, and loan documentation exceptions;
- (f) policies and/or procedures to ensure adequate pre- and post-funding analyses that conform with the guidance in the Rating Credit Risk Handbook;
- (g) policies and/or procedures to ensure adequate and timely collateral inspections/reviews;
- (h) 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;

(i) policies and/or 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; and

(j) appropriate risk management processes to limit risks associated with motel/hotel/occupancy related properties and out-of-area lending.

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

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

#### ARTICLE IV

##### CLASSIFIED & SPECIAL MENTION ASSETS

(1) Within sixty (60) days, the Board shall take all steps necessary to ensure reasonable oversight of a loan review that is effective, independent, and timely, i.e., conducted no less than annually. The loan review shall be responsible for timely identification and categorization of problem credits and shall:

(a) file a written report to be filed with the Board after each review; and

(b) use a loan and lease grading system consistent with the guidelines set forth in Rating Credit Risk, A-RCR, of the Comptroller's Handbook;

(2) The Bank shall take immediate and continuing action to protect its interest in those assets designated classified or special mention in the Bank's most recent Report of Examination, in any

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

(3) Within sixty (60) days, the Board shall adopt, implement, and thereafter ensure Bank adherence to a written program designed to eliminate the basis of criticism in assets designated classified or special mention in the Report of Examination, in any subsequent Report of Examination, or by any internal or external loan review, by internal problem loan identification processes, or in any list provided to management by the National Bank Examiners during any examination. This program shall require the Bank to include in its workout strategy for each classified or special mention asset:

- (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 timeframe for its accomplishment.

(4) Upon completion, a copy of the program shall be forwarded to the Assistant Deputy Comptroller within ten (10) days. Any subsequent modifications or additions to the program shall be forwarded to the Assistant Deputy Comptroller within ten (10) days of the modification or addition.

(5) The Board, or a designated committee, shall conduct a review, on at least a quarterly basis, to determine the status of each classified and special mention asset (or portion thereof) that equals or exceeds two hundred and fifty thousand dollars (\$250,000.00). Status updates for each classified or special mention asset (or portion thereof) that equals or exceeds two hundred and fifty thousand dollars

(\$250,000.00) shall be forwarded to the Assistant Deputy Comptroller on a quarterly basis. The status updates shall follow a format similar to Appendix A, attached hereto.

(6) On a quarterly basis, the Board, or a designated committee, shall conduct a written review of the classified and special mention asset program developed pursuant to this Article to determine:

- (a) management's adherence to the program adopted pursuant to this Article;
- (b) the status and effectiveness of the written program; and
- (c) the need to revise the program or take alternative action.

(7) A copy of the written review of the classified & special mention asset program shall be forwarded to the Assistant Deputy Comptroller within ten (10) days of completion.

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

## ARTICLE V

### STAFFING & SUCCESSION PLANNING

(1) Within sixty (60) days, the Board shall develop a staffing plan that is consistent with the goals and objectives established in the Bank's strategic plan, that is appropriate in light of the overall risk profile established for the Bank, and that rectifies any staffing-related deficiencies noted in the most recent ROE. At a minimum, the plan will consist of the following:

- (a) identification of the skills and expertise needed to develop, market, and administer the products identified in the strategic plan;
- (b) identification of the skills and expertise of the Bank's current staff;
- (c) comparison of the current staff's skills and expertise identified in (1)(b) of this Article to the skills and expertise identified in (1)(a) of this Article as necessary to

develop, market, and administer the products that will be utilized in accomplishing the Bank's goals and objectives; and

- (d) strategies to rectify any staffing-related deficiencies noted in the most recent ROE.

(2) Within ten (10) days of initial completion of the staffing plan, the Board shall provide a copy of its plan to the Assistant Deputy Comptroller for a written supervisory no objection. Upon receiving a written supervisory no objection, the Board shall promptly implement the plan. Thereafter, the Board will ensure that the Bank adheres to the staffing plan.

(3) Within sixty (60) days, the Board shall develop, implement, and thereafter adhere to a formal written management succession plan that shall, at a minimum:

- (a) identify present and future management and staffing requirements for each area of the Bank, including, but not limited to, identification of critical staff positions at the Bank;
- (b) outline strategies to promote the retention and continuity of capable management;
- (c) outline strategies to ensure both temporary and permanent qualified replacement of critical staff positions;
- (d) address whether the Bank has internal expertise and development capabilities to fill vacancies in critical staff positions or whether the Bank must resort to external recruitment; and
- (e) provide for annual review and assessment of the effectiveness of the succession plan.

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

## ARTICLE VI

### EMPLOYMENT OF CHIEF CREDIT OFFICER

(1) As soon as permissible in accordance with the prior notice requirements of 12 C.F.R. § 5.51, the Board shall employ a capable and experienced Chief Credit Officer to oversee the bank's lending function, strengthen credit risk management, and ensure the establishment of a credit culture that promotes conformance with lending policies and applicable credit and collateral controls.

(2) The Chief Credit Officer's skillset shall include the technical, analytical, and leadership skills needed to manage the specific types of loans in the Bank's lending portfolio and to oversee and control any credit concentrations.

(3) The Chief Credit Officer shall be vested with sufficient authority to fulfill the duties and responsibilities of overseeing the bank's lending function, including authority to make staffing/hiring decisions, adjust loan policies, and enforce credit underwriting and risk management processes.

(4) Prior to the employment of any individual to Chief Credit Officer position, the Board shall submit to the OCC the following:

- (a) the information required for a technically complete notice under 12 C.F.R. § 5.51;
- (b) a written statement of the Board's reasons for selecting the proposed officer; and
- (c) a written description of the proposed officer's duties and responsibilities.

(5) The OCC shall have the power to disapprove the appointment of the proposed Chief Credit Officer. However, the lack of disapproval of such individual shall not constitute an approval or endorsement of the proposed Chief Credit Officer.

(6) While 12 C.F.R. § 5.51 applies on the facts presented, this Article is based on the broader authority of 12 U.S.C. § 1818(b) and does not require the Comptroller or the Assistant Deputy Comptroller to complete a review and act on any such information or authority within ninety (90) days.



(7) The Board shall conduct appropriate succession planning for the Chief Credit Officer and other key leadership positions in the Bank to ensure the continuity of operations.

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

## ARTICLE VII

### CONSUMER COMPLIANCE PROGRAM

(1) Within sixty (60) days, the Board shall review, revise, and thereafter ensure adherence to a written consumer compliance program designed to ensure that the Bank is operating in compliance with all applicable consumer protection laws, rules, and regulations. This program shall include, but not be limited to:

- (a) a written description of the duties and responsibilities of the compliance officer (including any unrelated duties outside of the compliance area), which shall be appropriately tailored so that the compliance officer has adequate time to oversee the consumer compliance program;
- (b) adequate internal and/or outsourced staffing and resources to support the compliance officer;
- (c) adequate internal controls to ensure appropriate Board and Management oversight of the Bank's consumer compliance program and Bank compliance with consumer protection laws, rules, and regulations;
- (d) the preparation of a policies and procedures manuals covering all consumer protection laws, rules and regulations for use by appropriate Bank personnel in the performance of their duties and responsibilities;

- (e) annual reviews to ensure that compliance staff has kept the written policies and procedures manual current and reflective of changing regulatory requirements;
- (f) a risk-based audit program that timely and adequately tests for compliance with consumer protection laws, rules, and regulations;
- (g) procedures to ensure that exceptions noted in the audit reports are corrected and responded to by the appropriate Bank personnel in a timely manner;
- (h) periodic reporting of the results of the consumer compliance audit to the Board or a committee thereof; and
- (i) the education and training of all appropriate Bank personnel in the requirements of all federal and state consumer protection laws, rules and regulations.

(2) Upon adoption, a copy of the program shall be forwarded to the Assistant Deputy Comptroller for review.

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

## ARTICLE VIII

### INTERNAL AUDIT

(1) Within sixty (60) days, the Board shall review, revise, and thereafter ensure Bank adherence to a risk-based and independent internal audit program sufficient to:

- (a) detect irregularities and weak practices in the Bank's operations;
- (b) determine the Bank's level of compliance with all applicable laws, rules and regulations;

- (c) assess and report the effectiveness of policies, procedures, controls, and management oversight relating to high-risk areas as well as accounting and financial reporting;
- (d) 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;
- (e) determine whether regulatory reports contain "material misstatements"; and
- (f) 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 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) 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.

(6) 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.

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

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

## ARTICLE IX

### CLOSING

(1) Although the Board has agreed to submit certain programs and reports to the Assistant Deputy Comptroller for review or prior written determination of no supervisory objection, 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.

(5) In each instance in this Agreement 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:

- (a) 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 Agreement;
- (b) require the timely reporting by Bank management of such actions directed by the Board to be taken under the terms of this Agreement;
- (c) follow-up on any non-compliance with such actions in a timely and appropriate manner; and
- (d) require corrective action be taken in a timely manner of any non-compliance with such actions.

(6) This Agreement is intended to be, and shall be construed to be, a supervisory “written agreement entered into with the agency” as contemplated by 12 U.S.C. § 1818(b)(1), and expressly does not form, and may not be construed to form, a contract binding on the Comptroller or the United States. Notwithstanding the absence of mutuality of obligation, or of consideration, or of a contract, the Comptroller may enforce any of the commitments or obligations herein undertaken by the Bank under his supervisory powers, including 12 U.S.C. § 1818(b)(1), and not as a matter of contract law. The Bank expressly acknowledges that neither the Bank nor the Comptroller has any intention to enter into a contract. The Bank also expressly acknowledges that no officer or employee of the Office of the Comptroller of the Currency has statutory or other authority to bind the United States, the U.S. Treasury Department, the Comptroller, or any other federal bank regulatory agency or entity, or any officer or employee of any of those entities to a contract affecting the Comptroller’s exercise of his supervisory

responsibilities. The terms of this Agreement, including this paragraph, are not subject to amendment or modification by any extraneous expression, prior agreements or prior arrangements between the parties, whether oral or written.

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

/s/  
Jeffrey Speak  
Acting Assistant Deputy Comptroller  
San Antonio Field Office

12/14/16  
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.

/s/  
P. Malcolm Gulley

12-14-16  
Date

/s/  
Robert Ihrig

12-14-16  
Date

/s/  
Walter R. Long, Jr.

12-14-16  
Date

/s/  
Lou Eda Nixon

12-14-16  
Date

/s/  
H.B. (Trip) Ruckman, III

12-14-16  
Date

/s/  
Roxana P. Tom

12-20-16  
Date