

**UNITED STATES OF AMERICA**  
**Before The**  
**OFFICE OF THRIFT SUPERVISION**

In the Matter of	)	
	)	
<b>HORIZON BANK</b>	)	Order No.: MWR-07-4
<b>Oskaloosa, Iowa</b>	)	
<b>OTS Docket No. 00260</b>	)	Date: May 18, 2007
	)	

**STIPULATION AND CONSENT TO THE ISSUANCE OF AN  
ORDER TO CEASE AND DESIST FOR AFFIRMATIVE RELIEF**

**WHEREAS**, this Stipulation and Consent to the Issuance of an Order to Cease and Desist (Stipulation), which references the accompanying and above-referenced Order to Cease and Desist (Order), is submitted by **Horizon Bank**, Oskaloosa, Iowa (OTS Docket No. 00260) (Horizon or the Bank), to the Office of Thrift Supervision (OTS), which is acting through its Midwest Regional Director (Regional Director);

**WHEREAS**, OTS, based upon information derived from the exercise of its regulatory responsibilities, is of the opinion that grounds exist to initiate an administrative cease and desist proceeding against Horizon, pursuant to 12 U.S.C. § 1818(b)<sup>1</sup>,

**WHEREAS**, the Bank desires to cooperate with OTS and to avoid the time and expense of such administrative proceeding; and,

**WHEREAS**, the Bank (i) without any adjudication on the merits; (ii) without admitting or denying that such grounds exist; or (iii) without admitting or denying the Findings of Fact or opinions and conclusions of OTS, except as to Jurisdiction, Paragraph 1, below, which is admitted, hereby stipulates and agrees to the following:

1. **Jurisdiction**

- A. The Bank is a “savings association” within the meaning of 12 U.S.C. § 1813(b) and 12 U.S.C. § 1462(4). Accordingly, it is a “depository institution” as that term is defined in 12 U.S.C. § 1813(c).
- B. Pursuant to 12 U.S.C. § 1813(q), the Director of the OTS is the “appropriate Federal banking agency” with jurisdiction to maintain an administrative cease and desist proceeding against such savings association. Therefore, the Bank is subject to the

<sup>1</sup> All references to the United States Code (U.S.C.) are as amended, unless otherwise indicated.

jurisdiction of OTS to initiate and maintain cease and desist proceedings against it pursuant to 12 U.S.C. § 1818(b). The Deputy Director of OTS, pursuant to delegated authority from the Director of OTS, has delegated to the Regional Director the authority to issue cease and desist orders where the savings association has consented to the issuance of the orders.

2. **OTS Findings of Fact**

OTS finds that the Bank has engaged in violations of:

- A. 12 C.F.R. § 560.101(adequate real estate standards and reporting for high loan-to-value loans);
- B. 12 C.F.R. § 560.160(a) (establishment of asset classification system);
- C. 12 C.F.R. § 560.160(b) (establishment of adequate valuation allowances and charge-offs);
- D. 12 C.F.R. § 560.170(a) (adequate loan documentation so that the Board can make informed lending decisions and ongoing risk assessment);
- E. 12 C.F.R. § 560.170(b) (adequate assessment of borrower's and guarantor's ability to repay);
- F. 12 C.F.R. § 560.170(c) (enforceability of claims against borrower and collateral);
- G. 12 C.F.R. § 560.170(d) (administration and monitoring of loans);
- H. 12 C.F.R. § 560.170(e) (loan documentation that takes into consideration the size and complexity of the loan);
- I. 12 C.F.R. §§ 562.1(b)(2) and 562.2(b) (accurate filing of Thrift Financial Reports in accordance with instructions);
- J. 12 C.F.R. § 563.161(a) (sound financial policies);
- K. 12 C.F.R. § 563.170(c) (establishment of accurate and complete records of Horizon's business transactions);
- L. 12 C.F.R. § 564.3(b) (required evaluations for loans not requiring an appraisal);
- M. 12 C.F.R. § 564.8(c) (adequate appraisal practices); and
- N. 12 C.F.R. § 563.43 (regulatory requirements for insider loans).

3. **Consent**

- A. The Bank consents to the issuance by OTS of the accompanying Order.
- B. The Bank further agrees to comply with the terms of the Order upon issuance. The Bank further stipulates and agrees that the Order complies with all requirements of law.

4. **Finality**

The Order is issued under 12 U.S.C. § 1818(b). Upon its issuance by OTS, acting by and through its Regional Director, the Order shall be a final order, effective and fully enforceable by OTS under the provisions of 12 U.S.C. § 1818(i).

5. **Waivers**

The Bank waives the following:

- A. The right to be served with a written notice of OTS's charges against it as provided by 12 U.S.C. § 1818(b);
- B. The right to an administrative hearing of OTS's charges against it as provided by 12 U.S.C. § 1818(b);
- C. The right to seek judicial review of the Order, including, without limitation, any such right provided by 12 U.S.C. § 1818(h) and (i), or otherwise to challenge the validity of the Order;
- D. Any and all claims against OTS, including its employees and agents, and any other governmental entity for the award of fees, costs or expenses related to this OTS enforcement matter and/or the Order, whether arising under common law, the Equal Access to Justice Act, 5 U.S.C. § 504, or 28 U.S.C. § 2412; and
- E. The right to assert this proceeding, its consent to the issuance of the Order, the issuance of the Order, the payment of any monies or the provision of any other financial relief as contemplated by the Order as the basis for a claim of double jeopardy in any pending or future proceeding brought by the United States Department of Justice or any other governmental entity.

6. **Other Governmental Actions Not Affected**

- A. Upon OTS's issuance of the accompanying Order, following OTS's acceptance of this Stipulation, executed by the Bank, OTS does release and discharge the Bank from all potential claims and charges that have been or might have been asserted by OTS, based on the violations and safety and soundness deficiencies described in the Findings of Fact set forth in Paragraph 2 of this Stipulation, to the extent known to OTS as of the

effective date of the accompanying Order. However, the violations alleged above in Paragraph 2 of this Stipulation may be utilized by OTS in future enforcement actions to establish a pattern of practice of violations or the continuation of a pattern or practice of violations or to address any further adverse findings related to capital. This release shall not preclude or affect any right of OTS to determine and ensure compliance with the terms and provisions of this Stipulation and the Order.

- B. The Bank acknowledges and agrees that its consent to the issuance of the Order does not release, discharge, compromise, settle, dismiss, resolve, or in any way affect any actions, charges against, liability or other administrative, civil or criminal proceeding that may arise pursuant to this action or otherwise or that may be or has been brought by another governmental entity against the Bank or any institution-affiliated party thereof or by OTS against any institution-affiliated party of the Bank.

7. **Miscellaneous**

- A. The laws of the United States of America shall govern the construction and validity of this Stipulation and the Order.
- B. In case any provision of the Stipulation or Order is ruled to be invalid, illegal, or unenforceable by the decision of any Court of competent jurisdiction, the validity, legality, and enforceability of the remaining provisions hereof shall not in any way be affected or impaired thereby, unless the Regional Director in his or her sole discretion determines otherwise.
- C. All references to OTS or the Bank in this Stipulation and the Order shall also mean any of OTS's or Bank's predecessors, successors, and assigns, assuming OTS (or its successor) has jurisdiction over the Bank's successor or assign.
- D. The section and paragraph headings in this Stipulation and the Order are for convenience only and shall not affect the construction hereof of the Stipulation or the Order.
- E. The terms of this Stipulation and the Order represent the final written agreement of the parties with respect to the subject matters hereof, and constitute the sole agreement of the parties with respect to such subject matters.
- F. This Stipulation and the Order shall remain in effect until terminated, modified, or suspended in writing by OTS, acting through its Director, Deputy Director, Regional Director or other authorized representative.
- G. This Stipulation may be executed in counterparts by the directors after approval of its execution at a duly called board meeting.

8. **Signature of Directors**

Each Director of the Bank's Board of Directors signing this Stipulation attests that he/she voted in favor of a resolution authorizing the execution of the Stipulation. A copy of the resolution of the Board of Directors of Horizon Bank, authorizing execution of this Stipulation, shall be delivered to OTS, along with the executed original of this Stipulation.

**WHEREFORE, Horizon Bank, Oskaloosa, Iowa**, by its Board of Directors, executes this Stipulation and Consent to the issuance of the Order to Cease and Desist for Affirmative Relief, intending to be legally bound hereby.

**HORIZON BANK, Oskaloosa, Iowa**  
Approved by its Board of Directors

\_\_\_\_\_/s/  
James V. Hicks, Chairman of the  
Board and Director

\_\_\_\_\_/s/  
Michael F. Cooney, III, Director

\_\_\_\_\_/s/  
Robert W. DeCook, Director

\_\_\_\_\_/s/  
Megan McKay Ziller, Director

\_\_\_\_\_/s/  
Gary L. Rozenboom, Director

Accepted by:

**OFFICE OF THRIFT SUPERVISION**

By: \_\_\_\_\_/s/  
Frederick R. Casteel  
Regional Director  
Midwest Region

Effective Date: May 18, 2007

**UNITED STATES OF AMERICA**  
**Before The**  
**OFFICE OF THRIFT SUPERVISION**

In the Matter of	)	
<b>HORIZON BANK</b>	)	Order No.: MWR-07-4
<b>Oskaloosa, Iowa</b>	)	Date: May 18, 2007
<b>OTS Docket No. 00260</b>	)	

**CONSENT ORDER TO**  
**CEASE AND DESIST FOR AFFIRMATIVE RELIEF**

**WHEREAS, Horizon Bank, Oskaloosa, Iowa** (Horizon or Bank) (OTS Docket No. 00260), by and through its Board of Directors (Board), has executed a Stipulation and Consent to the Issuance of an Order to Cease and Desist for Affirmative Relief (Stipulation);

**WHEREAS,** the Bank, by execution of this Stipulation, has consented and agreed to the issuance of this Consent Order to Cease and Desist for Affirmative Relief (Order) by the Office of Thrift Supervision (OTS), pursuant to 12 U.S.C. § 1818(b);<sup>1</sup> and

**WHEREAS,** the Deputy Director of the OTS has delegated to the Regional Directors of OTS the authority to issue Orders to Cease and Desist on behalf of OTS where a savings association has consented to the issuance of the Order.

**NOW THEREFORE, IT IS ORDERED THAT:**

1. **Compliance with Regulatory Requirements**

The Bank and its directors, officers, employees, and agents, shall cease and desist from any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, aiding or abetting any unsafe or unsound practice or any violation of:

- A. 12 C.F.R. § 560.101(adequate real estate standards and reporting for high loan-to-value loans);
- B. 12 C.F.R. § 560.160(a) (establishment of asset classification system);
- C. 12 C.F.R. § 560.160(b) (establishment of adequate valuation allowances and charge-offs);
- D. 12 C.F.R. § 560.170(a) (adequate loan documentation so that the Board can make

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<sup>1</sup> All references to the United States Code (U.S.C.) are as amended, unless otherwise indicated.

- D. 12 C.F.R. § 560.170(a) (adequate loan documentation so that the Board can make informed lending decisions and ongoing risk assessment);
- E. 12 C.F.R. § 560.170(b) (adequate assessment of borrower's and guarantor's ability to repay);
- F. 12 C.F.R. § 560.170(c) (enforceability of claims against borrower and collateral);
- G. 12 C.F.R. § 560.170(d) (administration and monitoring of loans);
- H. 12 C.F.R. § 560.170(e) (loan documentation that takes into consideration the size and complexity of the loan);
- I. 12 C.F.R. §§ 562.1(b)(2) and 562.2(b) (accurate filing of Thrift Financial Reports in accordance with instructions);
- J. 12 C.F.R. § 563.161(a) (sound financial policies);
- K. 12 C.F.R. § 563.170(c) (establishment of accurate and complete records of Horizon's business transactions);
- L. 12 C.F.R. § 563.43 (regulatory requirements for insider loans);
- M. 12 C.F.R. § 564.3(b) (required evaluations for loans not requiring an appraisal); and
- N. 12 C.F.R. § 564.8(c) (adequate appraisal practices).

## 2. **Commercial Lending**

- A. The Bank shall submit all requests to engage in a commercial lending transaction to OTS at least 21 days prior to the anticipated loan approval date; however, the Bank shall not engage in any commercial lending transaction without the prior written notice of non-objection of the Regional Director. Such submissions shall include, but are not limited to: (1) a detailed description of the transaction; (2) documentation that demonstrates compliance with the Bank's loan policies and applicable regulations, including, but not limited to 12 C.F.R. §§ 560.101 and 560.170, and 12 C.F.R. Part 564; and (3) a copy of accurate and complete minutes reflecting the Board's review and conditional approval of the transaction.
- B. For purposes of this Order, a commercial lending transaction is defined as (1) all loans primarily for business or agricultural purposes, including but not limited to loans secured by, and to finance real estate granted for occupancy by a business or businesses, or where the rental or sale of the real estate provides the primary source of repayment; operating lines of credit; inventory financing; or equipment loans; (2) the renewal, modification, or extension of the aforementioned loans; (3) a commitment to renew, modify, purchase, or make the aforementioned loans; and (4) the direct or indirect purchase of aforementioned loans.

3. **Concentrations**

By **June 30, 2007**, the Board shall establish and submit a written notification to OTS regarding the establishment of a system to review and assess, on a periodic basis, the inherent risks associated with any concentrations of assets and liabilities, except for commercial real estate and loans (a) that are reviewed under Paragraph 7D hereof, that pose similar risk characteristics, including but not limited to economic, political, or environmental risks, and (b) that may exceed 25 percent of core capital and ALLL. Beginning with the **June 30, 2007 quarter** and thereafter, the Board's review of the concentrations shall include, but not be limited to, complex securities, Federal Home Loan Bank advances with imbedded options, and brokered deposits; and the Board shall address whether additional internal guidelines and concentrations limits are necessary to control the Bank's overall risk exposure. The Board shall ensure that its review of the Bank's concentrations are fully documented in its minutes.

4. **Collateral Evaluations**

- A. The Bank shall not make or refinance any loan secured by real estate without (1) obtaining an appraisal or evaluation as required by the Bank's loan policies and in accordance with the applicable requirements of 12 C.F.R. Part 564; Thrift Bulletin 55a, entitled "Interagency Appraisal and Evaluation Guidelines," dated November 4, 1994 (TB 55a), and CEO Letter No. 240, entitled "2006 Revisions to Uniform Standards of Professional Appraisal Practices," dated June 22, 2006 (CEO Letter No. 240), unless permission in writing is received from OTS; and (2) documentation in the loan file that the appraisal or evaluation has been reviewed and all deficiencies or violations of 12 C.F.R. Part 564 have been corrected.
- B. The Bank shall not make or refinance any secured loan that is not secured by real estate without (1) a collateral review report that addresses (a) the type and condition of the collateral and (b) the validation of the value of the underlying collateral, and (2) verification in the loan file that the collateral review report has been reviewed and all deficiencies have been corrected.
- C. By **May 15, 2007**, the Bank shall submit to OTS a copy of the appraisal of the collateral securing the loans referenced on page 40 of the January 3, 2007 Report of Examination (ROE) and such appraisals shall comply with 12 C.F.R. Part 564, TB 55a, and CEO Letter No. 240.
- D. By **May 15, 2007**, the Bank shall submit to OTS a copy of the report fully validating the value of the collateral securing the loans referenced on page 39 of the ROE. If, in the judgment of OTS, such report does not fully validate such value, the Bank will take such further action as OTS may request.
- E. By **May 31, 2007**, the Bank shall submit to OTS a copy of the report fully validating the value of the collateral securing the commercial loan referenced at the bottom of page 42 of the ROE. If, in the judgment of OTS, such report does not fully validate such value, the Bank will take such further action as OTS may request.

- F. By **June 30, 2007**, the Bank shall submit to OTS a copy of an appraisal for the collateral securing each loan referenced on pages 40-41 of the ROE that comply with 12 C.F.R. Part 564, TB 55a, and CEO Letter No. 240.
- G. By **June 30, 2007**, the Bank shall submit to OTS (1) a copy of the appraisal of the collateral securing the real estate loans referenced at the top of page 42 of the ROE, that comply with 12 C.F.R. Part 564, TB 55a, and CEO Letter No. 240, and (2) a copy of a report fully validating the value of collateral securing the commercial loans referenced at the top of page 42 of the ROE. If, in the judgment of OTS, such report does not fully validate such value, the Bank will take such further action as OTS may request.

5. **Asset Classification**

- A. By May 7, 2007, the Bank shall (1) adjust its internal asset classification to include all loans classified by OTS, (2) submit to OTS a copy of the journal entry establishing the additional allowances for loan and lease losses (ALLL) required by OTS, and (3) submit to OTS a copy of the updated list of classified assets. By **May 15, 2007**, the Bank shall submit to OTS a copy of a board resolution confirming the adjustments to the Bank's list of classified assets and the establishment of additional ALLL. The Board thereafter shall submit a copy of the updated list of classified assets and minutes reflecting the Board's review to OTS by **30 days after the end of the quarter beginning with the June 30, 2007 quarter**.
- B. By **June 30, 2007**, the Board shall adopt, and submit to OTS, a revised Asset Classification Policy that (1) complies with 12 C.F.R. § 560.160, Section 260 of the OTS Examination Handbook, Section II.G of Appendix A to 12 C.F.R. Part 570, and CEO Letter No. 250, entitled "Interagency Policy Statement on the Allowance for Loan and Lease Losses and Questions and Answers on Accounting for Loan and Lease Losses," dated December 13, 2006 (CEO Letter No. 250); (2) sets forth an enhancement of the ALLL methodology by loan type and credit grade of individual assets; (3) requires the procurement and review of appraisals, evaluations, or collateral validations for all assets classified substandard or worse that meets the standards of 12 C.F.R. Part 564, TB 55a, and CEO Letter No. 240, where applicable; (4) requires documentation and support for the classified asset category assigned by management; (5) requires a periodic evaluation of the allocation for ALLL; (6) requires any additional allocation of ALLL to be reflected in the Bank's books and records within 30 days after the evaluation and on the Bank's Thrift Financial Report (TFR); (7) requires the accurate reporting of classified assets on the Bank's Thrift Financial Report (TFR); (8) requires the establishment of applicable valuation allowance (SVA) or charge-offs for assets classified loss, and troubled debt restructuring in compliance with SFAS Nos. 5 and 114; and (9) requires a quarterly report to the Board regarding (a) the adequacy of ALLL to be determined and maintained for portfolio category in accordance with 12 C.F.R. § 560.160(b), the Bank's ALLL methodology, and CEO Letter No. 250; and (b) the required additional allocation of ALLL, SVAs, or charge-offs to be reflected in the Bank's books and records and inputted in the Bank's TFRs. By **June 30, 2007**, the Board shall submit to OTS a board resolution confirming the aforementioned actions taken by the Board.

- C. Beginning on **June 30, 2007, and quarterly thereafter**, the Board shall review and approve the adequacy of ALLL. The Board shall submit to OTS a copy of the Board minutes reflecting its review and approval and a copy of management's report by **30 days after the end of the quarter**.

6. **Internal Loan Review**

- A. By **May 15, 2007**, the Board shall adopt and submit to OTS a plan for implementation of an ongoing loan review process (Loan Review Plan) that is independent from the underwriting and administration process, utilizing the services of a qualified outside consultant or qualified employee. The Loan Review Plan shall (1) set forth the timeframe for the retention of a qualified outside consultant or the hiring of a qualified employee; (2) include a copy of a contract with an outside consultant and a description of the qualification of the consultant or employees; and (3) set forth timeframes and a plan for addressing the matters set forth in Paragraph 6B hereof.
- B. By **June 30, 2007**, the Board shall establish and Bank management shall comply with a loan review program (Loan Review Program) that addresses the following:
1. Correction of the loan underwriting, administration, and documentation deficiencies noted in the ROE, including, but not limited to the revision of underwriting standards, development of adequate loan documentation checklists, enhancement of loan presentations, review of appraisals and collateral valuations for compliance with this Order and any applicable requirements, and establishment of internal controls to enhance the detection of falsified information or misapplication of loan disbursements;
  2. Review of the Bank's loan policies and procedures for granting loan exceptions to ensure compliance with the requirements of 12 C.F.R. §§ 560.101 and 563.170, applicable sections of the OTS Examination Handbook, and this Order and submission of any required revisions to the Board for review and approval;
  3. Establishment of adequate internal controls to ensure that the documentation of loan transactions and the granting of loan exceptions comply with the Bank's revised loan policies, this Order, and applicable regulations and policy statements, including but not limited to 12 C.F.R. §§ 560.101 and OTS CEO Letter No. 252, entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices," dated December 14, 2006 (CEO Letter No. 252);
  4. Establishment of an ongoing credit administration process, including but not limited to (a) obtaining updated financial information from borrower(s) and/or guarantor(s) or credit reports during the term of the loan; (b) periodic documentation of the current collateral value or description of any changes in collateral; (c) tracking of the borrower's compliance with conditions of loan

approval; and (d) tracking of credit administration deficiencies and correction thereof; and

5. Identification and monitoring of problem assets.

By June 30, 2007, the Board shall submit to OTS a copy of the Loan Review Program.

- C. By June 18, 2007, the Board shall adopt, and submit to OTS, a plan to improve the collective lending expertise of the Board of Directors and the President (Lending Expertise Plan). The Lending Expertise Plan shall address (1) efforts to recruit board members with commercial lending expertise and (2) the provision of training of the Board and senior management, by a qualified vendor, **by June 30, 2007**, regarding, (a) the identification of and classification of problem assets; (b) review of classified assets and weekly delinquency reports, Schedule PD, Consolidated Past Due and Nonaccrual, and Schedule VA, Consolidated Valuation Allowances and Related Data, from the Bank's TFR; (c) red flags of fraud in loan transactions; (d) strategies for the administration of classified assets; and (e) strategies for the resolution of the classified assets. The Board shall submit to OTS monthly progress reports regarding the implementation of the Plan by the **first business day of each month, beginning July 1, 2007**.
- D. By **May 31, 2007**, the Board shall (1) review the audit of the single-family loan portfolio that had significant loan documentation deficiencies and management's estimate of the potential loss to the Bank and proposed additional ALLL, if necessary, and (2) determine what steps the Bank shall take to recoup or mitigate any loss and the time frames for such actions. The Bank shall submit to OTS a copy of the audit, management findings, and the Board's minutes reflecting its review and direction by **May 31, 2007**.
- E. By **May 31, 2007**, management shall submit to the Board, with a copy to OTS, (1) a status report regarding whether the disbursements for all construction loans classified "doubtful" and "loss" in the ROE were made in accordance with the loan documents, and (2) an outline of the next planned stages of the review. Management shall complete its review of the aforementioned construction disbursement, including whether they complied with the Bank's loan underwriting policy and administration procedures, and 12 C.F.R. § 560.170(d) and Appendix to 12 C.F.R. § 560.101 by June 30, 2007.
- F. The Bank shall not make a disbursement on a construction loan unless such disbursement complies with the Bank's loan policies, the loan documents, 12 C.F.R. § 560.170, Appendix to 12 C.F.R. § 560.101, and on-site progress inspections and budget comparisons.

7. **Loan Portfolio Review**

- A. By **June 30, 2007**, management, with the assistance of a qualified consultant, if appropriate, shall (1) review the Bank's real estate loan portfolio to identify all loans

- that exceed the supervisory loan-to-value limits (HLTV loans) as defined in Appendix to 12 C.F.R. § 560.101; (2) provide to the Board, with a copy to OTS, a list of all HLTV loans covered under Appendix to 12 C.F.R. § 560.101; (3) provide a report to the Board, with a copy to OTS, regarding (a) the aggregate amount of HLTV loans that do not fall within the list of excluded transactions and exceeding 100 percent of total capital and (b) the aggregate amount of all commercial, agricultural, multifamily, or other non-1-to-4 family residential properties that do not fall within the list of excluded transactions and exceeding 30 percent of total capital; and (4) submit a plan for ensuring that all HLTV loans are appropriately identified and that accurate reports are provided to the Board no less than **quarterly**, beginning with the **June 30, 2007** quarter. The Board shall review management's submission and give direction to management regarding the underwriting of HLTV loans and the reduction of any concentrations of HLTV loans no less than **quarterly**. The Board's review and determination shall be set forth in the Board minutes.
- B. By **July 15, 2007**, the Board shall adopt, and submit to OTS, for a written notice of non-objection, a plan to bring the HLTV loans that are covered by Appendix to 12 C.F.R. § 563.101 into compliance with the supervisory guidelines of 100 percent and 30 percent thresholds.
- C. By **June 30, 2007**, management shall update the Bank's loan processing data system with accurate and complete loan data in accordance with the Bank's plan submitted to OTS, dated May 4, 2007.
- D. By **July 15, 2007**, the Board shall adopt, and submit to OTS, a plan (Commercial and CRE Risk Assessment Plan) for assessing, monitoring, and controlling the risks associated with commercial real estate and commercial loan transactions in accordance with the guidelines in CEO Letter No. 252. The Commercial and CRE Risk Assessment Plan shall, at a minimum, address the following:
1. Delineation of an acceptable level of commercial real estate and commercial loan concentration risk that may include limits on certain types of borrowers or property types;
  2. Establishment of internal controls to monitor compliance with the concentration limits and the Bank's lending policy and strategies;
  3. Submission and review of information that identifies and quantifies the nature and level of risk presented by the commercial real estate and commercial concentration, including, but not limited to market reports for the Bank's lending territory;
  4. Periodic review and approval of the commercial real estate and commercial loan risk exposure limits;
  5. Establishment of a portfolio management process to evaluate the overall exposure to economic risk factors and to develop contingency plans to mitigate concentration risk in the event of adverse market conditions;

6. Development of a management information system that stratifies the commercial and commercial real estate loans by key factors used in delineating risks;
  7. Revision of commercial and commercial real estate underwriting policies, to the extent necessary, to (a) reflect the level of risk acceptable to the Board, the Bank's market position, historical experience, trade area, probable future loan and funding trends, staff capabilities, and technological resources; and (b) address (i) maximum loan amount by type of property, (ii) loan terms, (iii) pricing structures, (iv) collateral valuation, (v) loan-to-value limits by property type, (vi) requirements for feasibility studies and sensitivity analysis or stress testing, (vii) minimum requirements for initial investment and maintenance of hard equity by the borrower, (viii) minimum standards for borrower's net worth, property cash flow, and debt service coverage for the property, and (ix) limits on exceptions to the underwriting policies and requirements for detailed reports to the Board detailing management's approval, the number and the nature of the exceptions, the justifications for the exceptions, and analysis of trends relating to exceptions and any effect on established risk tolerance limits;
  8. Portfolio level stress tests or sensitivity analyses to quantify the impact of changing economic conditions, including, but not limited to those affecting certain relevant industries or sectors, on asset quality, earnings, and capital; and
  9. Credit risk review function that incorporates findings from the Bank's Loan Review Program established pursuant to Paragraph 6B hereof.
- E. By **July 25, 2007**, the Board shall submit to OTS a board resolution certifying that the Bank has completed the corrective actions set forth in Paragraphs 7A, C, and D hereof.
- F. By **July 15, 2007 for the June 30 quarter, and 15 days after each quarter end thereafter**, the Bank shall submit to OTS status reports on workout plans for all nonhomogeneous classified assets after review and approval by the Board. The status report shall set forth, at a minimum, (1) an analysis of the cash flow, (2) debt service coverage, (3) the current value of the collateral, (4) the borrower's and/or guarantor's financial condition, (5) asset classification and any allocated allowances, (6) date(s) of payments due and last payment made, and (7) the current strategy for resolving the classified asset that is approved by the Board. The designated staff shall develop a specific written loan workout plan for each nonhomogeneous classified asset within **10 business days** of the establishment of the adverse classification.

## 8. Thrift Financial Reports

- A. The Bank shall comply with 12 C.F.R. §§ 562.1 and 562.2 with respect to the accuracy of the Bank's TFRs.
- B. By **June 30, 2007**, management shall submit to the Board, with a copy to OTS, procedures and internal controls to ensure the accuracy of the Bank's TFRs, including but not limited to the information reported on Schedules CCR and CMR, and the

recording of the appropriate charge-offs and classified assets. The Bank shall comply with the procedures.

9. **Dividends**

The Bank shall continue not to declare, make, or pay any capital distributions without the prior written approval of the Regional Director and in accordance with 12 U.S.C. § 1467a(f).

10. **Growth and New Lines of Business**

- A. Except as otherwise permitted by a written notice of non-objection of the Regional Director, the Bank shall not increase its assets in any calendar quarter in excess of the amount of the net interest credited on its deposit liabilities during that quarter unless: (1) OTS has accepted the Bank's capital restoration plan in accordance with Paragraph 12 hereof, and (2) the increase in assets is consistent with the capital restoration plan. Any request for a growth exception shall include: (1) documentation showing that the growth will be supported by corresponding increases in tangible, core, and risk-based capital, and (2) documentation of the sources and uses of funds.
- B. The Bank may not, directly or indirectly, engage in any new lines of business or new activity, unless: (1) OTS has accepted the Bank's capital restoration plan as required by Paragraph 12 hereof, (2) the Bank is in compliance with the capital restoration plan, and (3) OTS determines the action is consistent with, and will further achievement of the capital restoration plan.

11. **Brokered Deposits**

The Bank may not accept, renew, or roll over any brokered deposit, except in accordance with 12 C.F.R. § 337.6(b)(2)(i), and with the prior written approval of the Federal Deposit Insurance Corporation (FDIC).

12. **Capital Restoration Plan**

- A. By June 18, 2007, the Board shall adopt, and submit to OTS, an acceptable comprehensive capital restoration plan and an updated three-year budget and business plan (Capital Plan). The Capital Plan shall set forth, in detail, the strategy for maintaining adequately capitalized status and the proposed strategy and timetable for becoming well capitalized and include:
1. A detailed discussion of the following: (a) the steps the Bank will take to become well capitalized, including underlying assumptions, and why they were chosen; (b) possibility of capital infusions from its holding company, Horizon Financial Services Corp., and the sale of facilities; (c) methodologies employed for forecasting the disposition of problem assets and the levels of expected charge-offs; (d) any substantial changes in assets and liabilities; (e) measures taken to eliminate its reliance on brokered deposits; (f) the types and levels of products and services, the delivery of such products and services, and the

discontinuance or reduction of commercial lending and commercial real estate; (g) strategies to control general and administrative expenses, including but not limited to costs associated with office facilities; (h) strategies to control concentration risks, interest-rate risk, credit risk, liquidity risk, and other significant risk exposures; and (i) the funding cash flow projections set forth in the Liquidity Policy as required by Paragraph 13 hereof; and

2. Quarterly financial projections that extend four quarters beyond the date the Bank becomes well capitalized and that are based on realistic assumptions of the following: (a) current Treasury rates and the implied interest rate forecast embedded in the existing yield curve for Treasury securities, with spreads over Treasury rates on incremental assets and liabilities consistent with prevailing market spreads; (b) prepayment rates that reflect the market's estimate for similar mortgage loans; (c) loan origination rates using recent experience and taking into consideration current national and regional economic conditions; (d) any increase in credit risk, interest-rate risk, liquidity risk, and compliance risk; (e) any significant increase in assets be accompanied by a corresponding increase in tangible capital and risk-based capital; and (f) any projected costs for management succession, a chief lending officer, the retention of outside consultants and/or counsel for asset review and problem workouts, and any other organizational and operational changes.
- B. The Board shall direct management to follow and implement the Capital Plan, including any amendments thereto, after receiving a written notice of non-objection from the Regional Director. The Bank shall submit any material deviation of, or modifications to the Capital Plan to OTS **30 days prior to implementation**, unless the Regional Director waives such time period.
- C. Management shall prepare, and submit to the Board, with a copy to OTS, **quarterly** variance reports on the Bank's compliance with the Capital Plan within **30 days after the close of each calendar quarterly period**. The Board's review of the Capital Plan and management's variance reports shall be fully documented in the Board meeting minutes, a copy of which shall be submitted to OTS. Such variance reports shall set forth: (1) actual operating results versus projected results and (2) detailed explanations of any material deviations from the Capital Plan and a specific description of the corrective actions or measures that have been implemented, proposed, or are under consideration to correct any material deviation. A deviation shall be considered material under Paragraph 12B when: (1) the Bank engages in any activity or operation, or line of business that is inconsistent with or that is not covered by the Capital Plan; or (2) the Bank falls below or fails to meet target amounts established in the Capital Plan by more than 10 percent unless the activity involves assets risk-weighted 50 percent or less, in which case a variance of more than 15 percent shall be deemed to be a material deviation. Notwithstanding the foregoing, none of the following deviations shall be deemed to be material: (1) a change of \$1 million in any balance sheet category, (2) a change of 10 percent or less in any income statement category. For purposes of this Paragraph, balance sheet category is defined as cash, investments, 1-4 family permanent mortgage loans, consumer loans, mortgage-backed securities, other investment securities, fixed assets, retail deposits,

wholesale deposits, advances from Federal Home Loan Bank, other borrowed money, other liabilities, and equity capital. For purposes of this Paragraph, income statement category is defined as interest income, interest expense, noninterest income, noninterest expense, extraordinary items, and net income.

- D. The Bank must provide notice no less than **ten (10) calendar days** after an event that caused its capital level to drop below what is required to be well capitalized as defined in 12 C.F.R. § 565.4(b).

13. **Liquidity Policy**

- A. By **May 31, 2007**, the Board shall adopt a revised Cash Flow/Liquidity Policy (Liquidity Policy) that sets forth a written strategy for the day-to-day management of liquidity and that complies with the guidelines set forth in Thrift Bulletin 77, entitled "Sound Practices for Liquidity Management at Savings Associations," dated June 19, 2001; and Sections 510 (Funds Management) and 530 (Liquidity Management) of the OTS Examination Handbook.
- B. The Liquidity Policy shall address: (1) the projected limits on the composition and maturities of assets and liabilities; (2) a process for measuring and monitoring net funding requirements; (3) contingency plans for addressing liquidity disruptions; (4) establishment of quantitative guidelines and limits to ensure adequate liquidity; (5) establishment of a process for measuring and monitoring liquidity, including but not limited to pro forma cash flow projections to projected cash inflows and outflows over different planning periods and under different scenarios; (6) the Bank's inability to accept, rollover, or renew brokered deposits while the Bank is adequately capitalized without the FDIC's approval; (7) contingency planning for handling unanticipated erosion in liquidity sources, and periodic review of the Bank's liquidity position and risk by the Board; and (8) establishment of internal control procedures to ensure adherence to the Bank's Liquidity Policy and Investment Portfolio Policy.
- C. Management shall make quarterly reports to the Board regarding the Bank's liquidity position in accordance with the guidelines set forth in Section 530 of OTS Examination Handbook, and the Board's review shall be reflected in the Board minutes.

14. **Service Corporation Activities**

By **May 31, 2007**, the Bank shall either (1) require its service corporation, Horizon Investment Services, Inc. to register as a broker/dealer with the Securities and Exchange Commission and obtain verification of such registration or (2) terminate its networking arrangement with Horizon Investment Services, Inc.

15. **Insider Loan Transactions**

By **May 23, 2007**, the Board shall adopt and submit to OTS a Board Resolution setting forth the implementation of internal controls to ensure that all transactions with insiders comply with Regulation O, 12 C.F.R. Part 215, and 12 C.F.R. § 563.43.

16. **Third Party Contracts**

- A. The Bank shall not enter into any third party contracts outside the normal course of business, as defined in Section 310, Management, of the OTS Examination Handbook and Thrift Bulletin 82a. The Bank shall provide at least a 30-day prior written notice to OTS. The notice, at a minimum, shall (1) set forth the Bank's reasons for entering into the contract, (2) include a draft copy of the contract, and (3) address compliance with the applicable factors set forth in Thrift Bulletin 82a.
- B. The Bank shall notify OTS in writing of any contracts or arrangements with service providers or third parties for an authorized service, regardless whether such service is performed on or off its premises, as required by 12 U.S.C. § 1464(d)(7)(D)(ii). The Bank must submit such notice to the Regional Director no later than **30 calendar days following** the earlier of the date the service provider becomes a party to a contract for such service (if there is a contract) or the date on which the performance of the service is initiated.

17. **Internal Audit**

By **July 31, 2007**, the Board shall adopt an internal audit plan (Internal Audit Plan) that addresses the guidelines set forth in Section 355, Internal Audit, of the OTS Examination Handbook and that (1) more clearly defines the role of the Audit Committee; (2) addresses whether the internal audit function will be handled internally by qualified staff or outsourced to a qualified entity or person; and (3) provides for risk-focused reviews of operations of the Bank and Horizon Investment Services, Inc. for (a) compliance with applicable laws and regulations, (b) effectiveness of internal controls and procedures, (c) compliance with the Bank's policies and procedures, and (d) efficiency of operations. The Bank shall not enter into any outsourcing arrangement for internal auditing unless the arrangement complies with the requirements of Section 355 of the OTS Examination Handbook. The Bank shall submit to OTS a copy of the draft outsourcing contract, if any; resumes of the individuals who will be performing the internal audit function; and the Internal Audit Plan by **July 31, 2007**.

18. **Staffing**

- A. By **June 18, 2007**, the Board shall adopt and submit to OTS a plan (Credit Staffing Plan) to improve the depth of the management of the Bank's credit department, including but not limited to (1) the hiring of a qualified chief credit officer in accordance with Paragraph 20 hereof; (2) an assessment of the responsibilities, skills, and training of the staff assigned to loan underwriting, loan administration, funding, and collections, and the determination of whether the employee has the time, resources, and training to perform properly his or her assigned functions; and (3) an assessment regarding whether any functions should be outsourced to a qualified consultant in accordance with an outsourcing arrangement that complies with the guidelines of Thrift Bulletin 82a. By the **seventh business day of each month**, the Bank shall submit a copy of the written progress report regarding the implementation of the Credit Staffing Plan to OTS.

- B. By **June 15, 2007**, the Board shall develop and submit to OTS its strategy to assess the duties and responsibilities assigned to each manager and to determine whether the manager has the time, resources, and training to perform properly all assigned functions, and whether any functions should be reassigned or transferred to a another qualified employee or a new qualified employee or outsourced to a qualified entity (Management Assessment Plan).
- C. By **July 25, 2007**, the Board shall adopt and submit to OTS the Management Assessment Plan setting forth the management resource assessment findings and corrective actions to address any deficiencies.

19. **Employment and Compensation Restrictions**

- A. The Bank shall not make any “golden parachute payments” (as that term is defined in 12 U.S.C. § 1828(k) and 12 C.F.R. Part 359), except as permitted under the applicable statute and regulation.
- B. The Bank shall not enter into any compensation arrangement with an officer or shall not enter into, renew, extend, or revise any employment contracts arrangement without the prior notice of non-objection of the Regional Director. Any such employment contract must comply with 12 C.F.R. Part 359, §§ 563.39 and 563.161(b), and Section III of Appendix A to 12 C.F.R. Part 570, and satisfy the guidelines for compensation arrangements set forth in Section 310, Management, of OTS Examination Handbook. For purposes of the Paragraph, the term “employment contract” includes any contract by the Bank with an individual to pay compensation in any form for any past, current, or anticipated future services as an officer, director, or a consultant or agent who exercises significant influence over, or participates in, major policymaking decisions, whether or not hired as an employee or given a title. For purposes of this Paragraph, the term “compensation” includes any payment of money or other items of value in consideration. Compensation includes, but is not limited to, base salary commissions, bonuses, pensions, and profit sharing plans, severance payments, retirement, director or committee fees, fringe benefits, and payment of expense items for a non-business purpose or that do not meet the Internal Revenue Service requirements for deductibility by the Bank. The Board’s analysis of all compensation arrangements shall address the factors set forth in Section 310 of the OTS Examination Handbook and shall be included as a part of any submission to OTS.
- C. The Board shall not pay any directors’ fees to board members and any committee fees to any board member or the President without the prior written approval of OTS.

20. **Restrictions on Adding or Replacing a Board Member, Employing a Senior Executive Officer, or Changing the Responsibilities of a Senior Executive Officer**

The Bank shall not add or replace any member of its Board, employ any new senior executive officer or change the responsibilities of any senior executive officer, except in accordance with 12 C.F.R. §§ 563.550 through 563.590, and 12 U.S.C. § 1831i.

## 21. Corporate Governance

- A. In accordance with 12 C.F.R. § 563.170(c), the Board and Committee minutes shall be a complete and accurate representation of meeting discussions, including dissenting opinions or votes, and the supporting documentation. The Board minutes shall reflect: (1) the Board's review and approval or disapproval of all significant transactions with appropriate documentation and management reports; (2) the Board's approval of all operating policies on a regularly scheduled basis throughout the year; (3) the Board's review of deviations and exceptions from the Bank's policies; and (4) the Board's review of management reports, including, but not limited to those required by this Order.
- B. Each Board and Committee member shall ensure that the minutes clearly and accurately reflect his or her actions, discussions, dissensions, and votes before approving the minutes. The Board and Committee members shall review and approve or modify the minutes at the next Board or Committee meeting.
- C. The former chairman shall continue to recuse himself from all actions pertaining to the approval of loans and the review and evaluation of loans subsequent to loan approval.

## 22. Compliance with Order

- A. All policies, procedures, corrective actions, plans, programs, and reviews required by this Order (collectively referred to as Plans and Policies) shall conform to all applicable statutes, regulations, and written OTS policy and guidance that has been published by OTS or distributed by OTS to OTS-regulated institutions. If OTS determines that such Plans and Policies do not so conform, the Board shall revise such Plans and Policies as required by OTS. The Bank shall comply with all Plans and Policies required by this Order, including any revisions or amendments required by OTS or to which OTS provided a written notice of non-objection. The Bank's failure to comply with a Plan or Policy required by this Order is considered a violation of this Order.
- B. The Board and management of the Bank shall take immediate action to cause the Bank to comply with the provisions of this Order.
- C. This Order requires the Bank to receive approval, notice of non-objection, or notice of acceptability from OTS for certain Board actions. The Board affirms that such regulatory oversight does not derogate or supplant each individual member's continuing fiduciary duty. The Board shall have the ultimate responsibility for overseeing the safe and sound operation of the Bank at all times, including but not limited to compliance with OTS's determinations as required by this Order.
- D. By the last calendar day of the month following each **calendar month**, beginning with the month of **May 2007**, the Board shall adopt and submit to OTS a certified copy of a board resolution formally resolving that, following a diligent inquiry of relevant information (including a report from Bank's management regarding the

Bank's compliance with each provision of this Order), to the best of its knowledge and belief, during the immediately preceding calendar month, the Bank has complied with each provision of this Order currently in effect, except as otherwise stated. The Compliance Resolution shall: (1) specify in detail how, if at all, full compliance was found not to exist; and (2) identify all notices of exemption or non-objection issued by OTS that were outstanding as of the date of its adoption. In the event that one or more directors do not agree with the representations set forth in a Compliance Resolution, such disagreement shall be noted in the Board meeting minutes.

### **MISCELLANEOUS**

#### **23. Definitions**

- A. All technical words or terms used in this Order and the corresponding Stipulation for which meanings are not specified or otherwise provided by the provisions of this Order shall, insofar as applicable, have meanings as defined in Chapter V of Title 12 of the Code of Federal Regulations, Home Owners' Loan Act (HOLA), Federal Deposit Insurance Act (FDIA), or OTS Publications. Any such technical words or terms used in this Order and undefined in Code of Federal Regulations, HOLA, FDIA, or OTS Publications shall have meanings that are in accordance with the best custom and usage in the savings and loan industry.
- B. For purposes of this Order, nothing shall be deemed "acceptable", as that term is used in this Order, unless the Regional Director, or the assigned OTS Regional Deputy Director or Assistant Director, has stated in writing that it is acceptable or has provided a written notice of non-objection to it.

#### **24. Successor Statutes, Regulations, Guidance, Amendments**

Reference in this Order to provisions of statutes, regulations, and OTS Publications shall be deemed to include references to all amendments to such provisions as have been made as of the Effective Date of this Order and references to successor provisions as they become applicable.

#### **25. Notices**

- A. Except as otherwise provided herein, any request, demand, authorization, directive, notice, consent, waiver or other document provided or permitted by this Order to be made upon, given or furnished to, delivered to, or filed with:
  1. OTS, by Horizon Bank, shall be addressed to the Assistant Director, Office of Thrift Supervision, Department of the Treasury, 225 East John Carpenter Freeway, Suite 500, Irving, Texas 75062-2327 or telecopied to (972) 277-9500; and
  2. Horizon Bank, by OTS, in each case shall be addressed to President or the Board of the Bank, at 301 1<sup>st</sup> Avenue E, Oskaloosa, Iowa 52577-3106 or telecopied to (641) 673-0074.

- B. Such delivery shall be sufficient for every purpose hereunder if in writing and mailed, first class, postage prepaid; sent via overnight delivery service; physically delivered; or means of electronic transmission. If there is a dispute about the date on which a written notice has been received by a party to this Order, then, in the event such notice was sent by United States mail, there shall be a presumption that the notice was received two (2) business days after the date of the postmark on the envelope in which the notice was enclosed.

26. **Time Limits and Suspension or Termination of Requirements**

Time limitations for compliance with the terms of this Order run from the Effective Date, unless otherwise noted. The Regional Director, or the assigned OTS Regional Deputy Director or Assistant Director, may extend any time limits set forth in this Order by specifically granting that extension in writing. The Regional Director may suspend or terminate the requirement of the Bank through a written notice that expressly provides for such suspension or termination.

27. **No Violations Authorized; OTS Not Restricted**

Nothing in this Order or the Stipulation shall be construed as: (a) allowing the Bank to violate any law, rule, regulation, or OTS's or Federal Deposit Insurance Corporation's policy statement to which it is subject, or (b) restricting or estopping the OTS from taking any action(s), including without limitation any actions that it believes are appropriate in fulfilling the responsibilities placed upon it by law.

28. **Effect of Headings**

The Section Headings herein are for convenience only and shall not affect the construction hereof.

29. **Incorporation**

The Stipulation is made a part hereof and is incorporated herein by this reference.

30. **OTS Review of Actions Requested**

The Regional Director, or the assigned OTS Regional Deputy Director or Assistant Director, may provide a written notice of non-objection, acceptability, or objection, or request additional information with respect to any submission to OTS required by this Order.

31. **Integration Clause**

- A. This Order represents the final written agreement of the parties with respect to the subject matter hereof and constitutes the sole agreement of the parties, as of the Effective Date, with respect to such subject matter. However, as noted herein, all Policies and Procedures (collectively, the Plans) required by this Order shall, upon

