

UNITED STATES OF AMERICA
Before the
OFFICE OF THRIFT SUPERVISION

In the Matter of)	Order No.: SE-10-056
)	
)	
HARRINGTON BANK, FSB)	Effective Date: November 23, 2010
)	
Chapel Hill, North Carolina)	
OTS Docket No. 17910)	

ORDER TO CEASE AND DESIST

WHEREAS, Harrington Bank, FSB, Chapel Hill, North Carolina, OTS Docket No. 17910 (Association), by and through its Board of Directors (Board), has executed a Stipulation and Consent to the Issuance of an Order to Cease and Desist (Stipulation); and

WHEREAS, the Association, by executing the Stipulation, has consented and agreed to the issuance of this Order to Cease and Desist (Order) by the Office of Thrift Supervision (OTS) pursuant to 12 U.S.C. § 1818(b); and

WHEREAS, pursuant to delegated authority, the OTS Regional Director for the Southeast Region (Regional Director) is authorized to issue Orders to Cease and Desist where a savings association has consented to the issuance of an order.

NOW, THEREFORE, IT IS ORDERED that:

Cease and Desist.

1. The Association, its institution-affiliated parties,¹ and its successors and assigns, shall cease and desist from any action (alone or with others) for or toward causing, bringing about, participating in, counseling, or the aiding and abetting the unsafe or unsound banking practices that resulted in:

- (a) operating the Association with an inadequate level of capital protection for the volume, type and quality of assets held by the Association;
- (b) operating with inadequate earnings to augment capital and support reserves;
- (c) operating with an excessive level of adversely classified loans and assets;
- (d) creating and operating with an excessive concentration of commercial real estate and construction loans.
- (e) operating the Association with a materially underfunded ALLL and inaccurately reported and understated classified assets.
- (f) engaging in unsafe and unsound practices by failing to:
 - (i) provide OTS with an acceptable business plan and capital plan that included reasonable strategies to preserve and enhance capital, improve asset quality, and strengthen and improve earnings;
 - (ii) adopt and implement acceptable Allowance for Loan Lease Loss (ALLL) policies, procedures and methodologies that ensured the timely establishment and maintenance of adequate ALLLs;

2. The Association, its institution-affiliated parties, and its successors and assigns, shall also cease and desist from any action (alone or with others) for or toward causing, bringing about,

¹ The term “institution-affiliated party” is defined at 12 U.S.C. § 1813(u).

participating in, counseling, or the aiding and abetting violations of the following laws and regulations:

- (a) 12 C.F.R. § 560.101 (regarding Real Estate Lending Standards);
- (b) 12 C.F.R. § 560.160 (regarding accurate and timely classification of assets);
- (c) 12 C.F.R. § 563.161 (regarding safe and sound management and financial policies); and
- (d) 12 C.F.R. § 563.170(c) (regarding establishment and maintenance of accurate books and records).

Capital.

3. Effective immediately, the Association shall have and maintain a Tier 1 (Core) Capital Ratio equal to or greater than eight percent (8%) and a Total Risk-Based Capital Ratio equal to or greater than twelve percent (12%).²

4. By December 15, 2010, the Association shall submit a written plan to achieve and maintain the Association's capital at the levels prescribed in Paragraph 3 (Capital Plan) that is acceptable to the Regional Director. At a minimum, the Capital Plan shall:

- (a) identify the specific sources of additional capital and the timeframes and methods by which additional capital will be raised, including specific target dates and corresponding capital levels;
- (b) detail the Association's capital preservation and enhancement strategies with specific narrative goals;

² The requirement in Paragraph 3 to have and maintain a specific capital level means that the Association may not be deemed to be "well-capitalized" for purposes of 12 U.S.C. §1831o and 12 C.F.R. Part 565, pursuant to 12 C.F.R. §565.4(b)(1)(iv).

(c) address the requirements and restrictions imposed by this Order relating to capital under different forward-looking scenarios involving progressively stressed economic environments;

(d) include detailed quarterly financial projections, including Tier 1 (Core) and Total Risk-Based Capital Ratios;

(e) address the Association's level of classified assets, ALLL, earnings, asset concentrations, liquidity needs, and trends in the foregoing areas; and

(f) address current and projected trends in real estate market conditions.

5. Upon receipt of written notification from the Regional Director that the Capital Plan is acceptable, the Association shall implement and adhere to the Capital Plan. A copy of the Capital Plan and the Board meeting minutes reflecting the Board's adoption thereof shall be provided to the Regional Director within twenty (20) days after the Board meeting.

6. At each monthly board meeting, beginning with the December 2010 board meeting, the Board shall review the Association's compliance with the Capital Plan. At a minimum, the Board's review shall include:

(a) a comparison of actual operating results to projected results;

(b) detailed explanations of any material deviations;³ and

(c) a discussion of specific corrective actions or measures that have been or will be implemented to address each material deviation.

7. Within fifteen (15) days after: (a) the Association fails to meet the capital requirements prescribed in Paragraph 3; (b) the Association fails to comply with the Capital Plan prescribed in

³ A deviation shall be considered material under this Paragraph of the Order when the Association: determines that it needs to adjust its identified sources of additional capital, timeframes, methods, or target dates by which it will raise capital.

Paragraph 4; or (c) any written request from the Regional Director, the Association shall submit a written Contingency Plan that is acceptable to the Regional Director.

8. The Contingency Plan shall detail the actions to be taken, with specific time frames, to achieve one of the following results by the later of the date of receipt of all required regulatory approvals or sixty (60) days after the implementation of the Contingency Plan: (a) merger with, or acquisition by, another federally insured depository institution or holding company thereof; or (b) voluntary dissolution by filing an appropriate application with the OTS in conformity with applicable laws, regulations and regulatory guidance.

9. Upon receipt of written notification from the Regional Director, the Association shall implement and adhere to the Contingency Plan immediately. The Association shall provide the Regional Director with written status reports detailing the Association's progress in implementing the Contingency Plan by no later than the first (1st) and fifteenth (15th) of each month following implementation of the Contingency Plan.

Business Plan.

10. Within sixty (60) days, the Association shall submit a comprehensive business plan for the remainder of calendar year 2010 and calendar years 2011 and 2012 (Business Plan) that addresses all corrective actions in the 2010 Examination relating to the Association's business operations to the Regional Director for review and non-objection. Thereafter, the Association shall submit an updated three year Business Plan at least ninety (90) days prior to the end of each calendar year. At a minimum, the Business Plan shall conform to applicable laws, regulations and regulatory guidance and include:

- (a) plans to improve the Association's core earnings and achieve profitability on a consistent basis throughout the term of the Business Plan;

- (b) detailed strategies and actions the Association will take to reduce the overall risk profile of the Association;
- (c) specific targets and dates and supporting documentation to demonstrate the reduction in the overall risk profile of the institution;
- (d) detailed strategies and actions to reduce the outstanding balance of the non-homogenous lending portfolios, and any asset categories that present higher or unusual risk characteristics;
- (e) a written contingency funding plan that complies with applicable law, regulation and regulatory guidance and will ensure that the Association maintains adequate liquidity to meet deposit demands, including extraordinary deposit demands;
- (f) quarterly pro forma financial projections (balance sheet, regulatory capital ratios, and income statement) for each quarter covered by the Business Plan; and
- (g) consideration of the requirements of this Order.

11. Upon receipt of written notification of non-objection from the Regional Director, the Association shall implement and adhere to the Business Plan. A copy of the Business Plan and the Board meeting minutes reflecting the Board's adoption thereof shall be provided to the Regional Director within twenty (20) days after the Board meeting.

12. Any material modifications⁴ to the Business Plan must receive the prior written non-objection of the Regional Director. The Association shall submit proposed material modifications to the Regional Director at least forty-five (45) days prior to implementation.

⁴ A modification shall be considered material under this Section of the Order if the Association plans to: (a) engage in any activity that is inconsistent with the Business Plan; or (b) exceed the level of any activity contemplated in the Business Plan or fail to meet target amounts established in the Business Plan by more than ten percent (10%), unless the activity involves assets risk-weighted fifty percent (50%) or less, in which case a variance of more than twenty-five percent (25%) shall be deemed to be a material modification.

13. Within thirty (30) days after the end of each quarter, beginning with the Quarter ending December 31, 2010, the Board shall review quarterly variance reports on the Association's compliance with the Business Plan (Variance Reports). The Variance Reports shall:

- (a) identify variances in the Association's actual performance during the preceding quarter as compared to the projections set forth in the Business Plan;
- (b) contain an analysis and explanation of identified variances; and
- (c) discuss the specific measures taken or to be taken to address identified variances.

14. A copy of the Variance Reports and Board meeting minutes shall be provided to the Regional Director within ten (10) days after the Board meeting.

Growth.

15. Effective immediately, the Association shall not increase its total assets during any quarter in excess of an amount equal to net interest credited on deposit liabilities during the prior quarter without the prior written notice of non-objection of the Regional Director.

Internal Asset Review and Classification.

16. Within sixty (60) days, the Association shall revise its written internal asset review and classification program (IAR Program) to address all corrective actions set forth in the 2010 Examination relating to internal asset review and classification. The IAR Program shall comply with all applicable laws, regulations and regulatory guidance and shall:

- (a) ensure the accurate and timely identification, classification, and reporting of the Association's assets, including the designation of loans as special mention or placement of loans on a watch list where a borrower's credit standing has deteriorated on an ongoing basis ;
- (b) detail the Association's loan grading system and specify parameters for the

identification of problem loans for each type of loan offered by the Association;

(c) redefine the criteria used for the internal “5” classification rating grade to ensure that all loans that exhibit well defined weaknesses are designated special mention or adversely classified.

(d) provide for the appointment of a qualified, experienced, and independent third party to conduct, at a minimum, annual reviews of the Association’s loan portfolio and assessments of the Association’s internal asset review process thereof. At least ninety percent of the Association’s commercial real estate loans should be subject to independent review;

(e) provide for procedures to ensure that repossessed assets are accounted for in accordance with generally accepted accounting principles.

(f) be independent of the Association’s lending function and report to a Board level committee that is independent of the Association’s lending function.

17. Within sixty (60) days, the Association shall engage an independent third party to review its credit administration process including, but not limited to, a review of all loans internally graded a “5” and all loans secured by stock, to ensure that all loans have been timely and properly classified.

Allowance for Loan and Lease Losses.

18. Within sixty (60) days, the Association shall revise its policies, procedures, and methodology relating to the timely establishment and maintenance of an adequate ALLL level (ALLL Policy) to address all corrective actions set forth in the 2010 Examination relating to ALLL, and specifically, ensure that all FAS 114 losses are included and properly calculated.

The ALLL Policy shall comply with applicable laws, regulations, and regulatory guidance and shall:

- (a) incorporate the results of all internal loan reviews and classifications;
- (b) address the historical loan loss rates of the Association in compliance with regulatory guidance, which shall be updated quarterly with heavier weighting assigned to rates of the most recent quarters;
- (c) require an expanded segmentation of the Association's loan portfolio for internal loan review analysis;
- (d) include an estimate of the potential loss exposure on each significant⁵ credit;
- (e) require the stress testing of loss rates and delinquency rates to: (i) determine the sensitivity of the ALLL methodology to changes from primary inputs; (ii) provide information regarding the risk of miscalculation if the credit environment changes; and (iii) evaluate the appropriateness of the ALLL in a range of credit environments; and
- (f) address the level and impact of the Association's current concentrations of credit, including geographic concentrations.

19. Within seventy (70) days, the Association shall submit a copy of its ALLL Policy to the Regional Director. The Association shall implement and adhere to the ALLL Policy.

20. Within thirty (30) days after the end of each quarter, beginning with the quarter ending December 31, 2010, the Association shall analyze the adequacy of the ALLL consistent with its ALLL Policy (Quarterly ALLL Report). The Board's review of the Quarterly ALLL Report, including, but not limited to, all qualitative factors considered in determining the adequacy of the

⁵ A credit shall be considered significant for the purposes of assessing, establishing, and maintaining an appropriate level of ALLL if it is/was Five Hundred Thousand Dollars (\$500,000.00) or greater at origination.

Association's ALLL, shall be fully documented in the Board meeting minutes. Any deficiency in the ALLL shall be remedied by the Association in the quarter in which it is discovered and before the Association files its Thrift Financial Report (TFR) with the OTS. A copy of the Quarterly ALLL Report and the Board meeting minutes detailing the Board's review shall be provided to the Regional Director within ten (10) days after the Board meeting.

Loan Underwriting.

21. Within sixty (60) days, the Association shall revise its loan underwriting policies, procedures, practices, and controls (Loan Underwriting Policy) to address all corrective actions in the 2010 ROE relating to loan underwriting. The Loan Underwriting Policy shall comply with applicable laws, regulations and regulatory guidance and shall, at a minimum:

- (a) establish specific debt service to income ratios for each loan type; and
- (b) establish income documentation requirements for all borrowers that demonstrate the borrower's ability to meet all contractual debt service obligations from current, verified net income and cash flow.
- (c) ensure that all loans secured by stock comply with applicable law and regulation including, but not limited to Regulation U, and that such loans are underwritten with appropriate margin provisions, routinely monitored for compliance with established margin provisions, appropriate action is taken to minimize loss exposure.

Credit Administration.

22. Within sixty (60) days, the Association shall revise and implement credit administration policies, procedures, practices, and controls (Credit Administration Policy) to address all corrective actions in the 2010 ROE relating to credit administration. The Credit Administration Policy shall comply with all applicable laws, regulations and regulatory guidance and include:

- (a) restrictions on loan renewals granted without modifications;
- (b) restrictions on additional advances to borrowers who have an existing loan with the Association that is adversely classified;
- (c) policies, procedures, and systems to obtain and analyze, on at least an annual basis, updated borrower financial information on nonhomogeneous loans;
- (d) guidelines requiring that collateral properties be re-appraised prior to loans being modified, extended, or refinanced;
- (e) guidelines requiring that current financials statements from the borrower be provided to the Association prior to loans being modified, extended or refinanced and that such financial statements be reviewed to determine whether the borrower has the ability to repay at the modified loan terms;
- (f) an effective system for the retention, review, renewal, and updating by the Association of all required records, filings, and other credit related documents;
- (g) procedures for monitoring loans secured by stock and the establishment of guidelines and actions to be taken to mitigate potential loss; and
- (h) funding controls over costs on construction projects to prevent disbursements of loan funds in excess of completed construction costs.

Insider Policy.

23. Within sixty (60) days, the Association shall revise its written policy governing all transactions between the Association and Insiders⁶ (Insider Policy) to address all corrective actions in the 2010 ROE relating to transactions with insiders and ensure the Association's

⁶ 12 C.F.R. § 215.2(h).

compliance with applicable law, regulation and guidance. At a minimum, the Insider Policy shall:

- (a) establish guidelines and requirements that define and establish procedures to prevent conflicts of interest, including appearances of conflicts of interest, and breaches of fiduciary duty;
- (b) establish procedures for consultation with Association or personal legal counsel before entering into or approving transactions involving the Association and an Insider;
- (c) establish procedures for ensuring that transactions between the Association and Insiders are fully documented, including, but not limited to: independent appraisals of property securing Insider loans, information demonstrating that an Insider loan is made of comparable terms with specific loans made by the Association to non-insiders; documentation to identify any related interests of Insiders; Board minutes reflecting both the Loan Committee's and the Board's deliberations regarding Insider loans; and Board actions approving or denying Insider loans;
- (d) require disclosure of interests in transactions or parties to transactions that may result in actual or potential conflicts of interest, and periodic disclosure of related interests as defined by 12 C.F.R. Part 215; and
- (e) require disclosure of any Insider's material interest in the business of a borrower, an applicant, or other customer of the Association.

24. A copy of the Insider Policy shall be provided to the Regional Director within ten (10) days following completion. Within thirty (30) days of receipt of any comments from the Regional Director, the Board shall incorporate the comments into and implement and adhere to the revised Insider Policy.

Credit Risk Management.

25. Within sixty (60) days, the Association shall employ an experienced and qualified credit risk manager who will work independently of the loan origination and approval process, has not previously been part of the loan origination or approval process, and reports directly to the Board.

New Board Members.

26. By March 31, 2011, the Association shall consistent with Paragraph 37 of this Order, notify the OTS of new qualified members for the Board of Directors (Board) who are independent with respect to the Association.⁷ The Association shall ensure that all of the Board's committees include representation of the new Board members. The Board shall fully document the Association's efforts in the monthly board meeting minutes.

Books and Records.

27. Effective immediately, the Association shall establish and maintain complete and accurate books, records and documentation for all business and transactions in compliance with applicable law, regulation and regulatory guidance. Such books, records and documentation shall include, but are not limited to, board and committee minutes that completely and accurately represent meeting discussions, including dissenting opinions or votes. All board and committee

⁷ For purposes of this Order, an individual who is "independent with respect to the Association" shall be any individual who:

- a. is not employed in any capacity by the Association, any of its subsidiaries, or affiliated organizations, other than as a director;
- b. does not own or control more than 10 percent of the outstanding shares of the Association or its parent company;
- c. is not related by blood or marriage to any officer or director of the Association or its affiliates, or to any shareholder owning more than 10 percent of the outstanding shares of the Association or its parent company, and who does not otherwise share a common financial interest with any such officer, director or shareholder; and
- d. is not indebted, directly or indirectly, to the Association or any of its affiliates, including the indebtedness of any entity in which the individual has a substantial financial interest, in an amount exceeding 10 percent of the Association's total Tier 1 capital and allowance for loan and lease losses.

meeting minutes should be ratified and signed by the Chairman and Secretary of the Board or the committee.

Management Assessment Report.

28. Within ninety (90) days, the Association shall submit to the Regional Director for review a written assessment of the Association's Board and management prepared by an independent third-party (Management Study). The Management Study shall address the adequacy, suitability and effectiveness of the Association's management (at both board and executive levels) in light of the size, complexity, operations and risk profile of the Association, and specifically address the management and staffing of the Association's lending, asset classification, and enterprise risk management functions. The Management Study shall address the requirements imposed by this Order and shall evaluate and determine responsibility for the current condition of the Association and make recommendations with respect to changes and/or additions to the current Board of Directors, management, and staff.

29. Within sixty (60) days of receipt of the Management Study, the Association shall implement all recommendations of the Management Study or, within the same timeframe, provide the Regional Director with a detailed written explanation for each recommendation that was rejected by the Association.

Lending.

30. Effective immediately, the Association shall not originate or purchase, or commit to originate or purchase, any new construction loans⁸, nonresidential real estate loans, multifamily

⁸ The term "construction loan" does not include contract construction loans that meet all of the following criteria:

- a. the borrower on the mortgage loan must be the occupant of the home, it may not be the builder;
- b. the borrower must be pre-qualified for a permanent mortgage loan or certify and document that the borrower has sufficient funds available at the time the contract construction loan is made to repay the contract construction loan;

loans, land loans or loans secured by stock or extend additional funds to existing borrowers on or relating such loans.

Concentrations of Credit.

31. Within sixty (60) days, the Association shall revise its written program for identifying, monitoring, and controlling risks associated with concentrations of credit (Credit Concentration Program) to address all corrective actions set forth in the 2010 Examination relating to concentrations of credit, and to ensure that all elements of CEO Memo 252 are addressed, including establishing a credit risk review function and conducting stress tests of the various portfolios. The Credit Concentration Program shall comply with all applicable laws, regulations and regulatory guidance and shall, at a minimum:

(a) establish prudent concentration limits for all major loan and asset categories expressed as a percentage of Core Capital plus ALLL, including limits for permanent multifamily loans and commercial nonmortgage loans; and documenting the appropriateness of such limits based on the Association's risk profile;

(b) establish stratification categories of the Association's concentrations of credit, such as (*e.g.*, land loans, construction loans, income property loans, nonresidential real estate loans, commercial loans) and establish enhanced risk analysis, monitoring, and management, including stress testing, for each stratification category;

c. the borrower must have at least a twenty (20) percent equity in the transaction calculated based upon the lower of appraised value of the completed home or the total construction contract amount including the value of the lot upon which the home will be constructed;

d. the borrower's funds must be disbursed to the builder prior to the disbursement of any Association loan proceeds;

e. contract construction loan disbursement checks must be made payable to both the borrower and the builder; and

f. Association Management must certify that they have reviewed the contract between the borrower and the builder prior to the approval of the contract construction loan.

(c) contain specific review procedures and reporting requirements, including written reports to the Board, designed to identify, monitor, and control the risks associated with concentrations of credit and periodic market analysis for the various property types and geographic markets represented in its portfolio; and

(d) contain a written action plan, including specific time frames, for bringing the Association into compliance with its concentration limits and for reducing exposure to concentrations of credit.

32. Effective immediately, Management shall prepare and submit for Board review a written report assessing the Association's compliance with the revised Credit Concentration Program within thirty (30) days after the close of each calendar quarter (Concentration Report). The Board's review of the Concentration Report, including any corrective actions adopted by the Board, shall be fully documented in the appropriate Board meeting minutes. A copy of the Concentration Report and any supporting documents, reports, or other information reviewed by the Board, and the Board meeting minutes detailing the Board's review shall be provided to the Regional Director within ten (10) days after the Board meeting.

Problem Asset Plan.

33. Within sixty (60) days, the Association shall submit a detailed, written plan with specific strategies, targets and timeframes to reduce⁹ the Association's level of problem assets¹⁰ (Problem Asset Reduction Plan) to the Regional Director for review and non-objection. Upon receipt of written non-objection from the Regional Director, the Association shall implement and adhere to the Problem Asset Reduction Plan. The Problem Asset Reduction Plan, at a minimum, shall

⁹ For purposes of this Paragraph, "reduce" means to collect, sell, charge off, or improve the quality of an asset sufficient to warrant its removal from adverse criticism or classification.

¹⁰ The term "problem assets" shall include all classified assets, assets designated special mention, nonperforming assets, real estate owned, and delinquent loans.

include:

- (a) monthly targets for the level of problem assets expressed as dollar amounts and a percentage of Tier 1 (Core) capital plus ALLL;
- (b) a description of the specific methods for reducing the Association's level of problem assets to the established targets; and
- (c) all relevant assumptions and projections.

34. Effective immediately, the Association shall revise all individual written specific workout plans for each problem asset, group of loans to any one borrower or lending relationship of Five Hundred Thousand Dollars (\$500,000) or greater (Asset Workout Plans) to address all corrective actions in the 2010 Examination. Each Asset Workout Plan shall:

- (a) contain detailed strategies and actions that are designed to eliminate the basis of criticism or classification for each asset, and must not include the acquisition of troubled loans from other lenders to the same borrower as a strategy;
- (b) include specific timeframes for the completion of all detailed strategies and actions, including an exit strategy for each problem asset;
- (c) include a list of any credit and collateral documentation that is needed to comply with the Associations lending and appraisal policies; and
- (d) detail the actions and steps the Association will take to obtain any needed credit and collateral documentation.

35. Within thirty (30) days after the end of each quarter, beginning with the quarter ending September 30, 2010, the Association shall submit a quarterly written asset status report (Quarterly Asset Report) to the Board. The Board's review of the Quarterly Asset Report shall be documented in the Board meeting minutes. The Quarterly Asset Report shall include, at a

minimum:

- (a) the current status of all Asset Workout Plans;
- (b) a comparison of problem assets to Tier 1 (Core) capital plus ALLL and Total Risk-Based capital;
- (c) a comparison of problem assets at the current quarter end with the preceding quarter;
- (d) a breakdown of problem assets by type and risk factor;
- (e) an assessment of the Association's compliance with the Problem Asset Reduction Plan; and
- (f) a discussion of the actions taken during the preceding quarter to reduce the Association's level of problem.

36. Within twenty (20) days after the end of each quarter, a copy of the Quarterly Asset Report shall be provided to the Regional Director.

Directorate and Management Changes.

37. Effective immediately, the Association shall comply with the prior notification requirements for changes in directors and Senior Executive Officers¹¹ set forth in 12 C.F.R. Part 563, Subpart H.

Golden Parachute and Indemnification Payments.

38. Effective immediately, the Association shall not make any golden parachute payment¹² or prohibited indemnification payment¹³ unless, with respect to each such payment, the Association

¹¹ The term "Senior Executive Officer" is defined at 12 C.F.R. § 563.555.

¹² The term "golden parachute payment" is defined at 12 C.F.R. § 359.1(f).

¹³ The term "prohibited indemnification payment" is defined at 12 C.F.R. § 359.1(l).

has complied with the requirements of 12 C.F.R. Part 359 and, as to indemnification payments, 12 C.F.R. § 545.121.

Employment Contracts and Compensation Arrangements.

39. Effective immediately, the Association shall not enter into, renew, extend or revise any contractual arrangement relating to compensation or benefits for any Senior Executive Officer or director of the Association, unless it first provides the Regional Director with not less than thirty (30) days prior written notice of the proposed transaction. The notice to the Regional Director shall include a copy of the proposed employment contract or compensation arrangement or a detailed, written description of the compensation arrangement to be offered to such officer or director, including all benefits and perquisites. The Board shall ensure that any contract, agreement or arrangement submitted to the Regional Director fully complies with the requirements of 12 C.F.R. Part 359, 12 C.F.R. §§ 563.39 and 563.161(b), and 12 C.F.R. Part 570 – Appendix A.

Dividends and Other Capital Distributions.

40. Effective immediately, the Association shall not declare or pay dividends or make any other capital distributions, as that term is defined in 12 C.F.R. § 563.141, without receiving the prior written approval of the Regional Director in accordance with applicable regulations and regulatory guidance. The Association’s written request for approval shall be submitted to the Regional Director at least thirty (30) days prior to the anticipated date of the proposed declaration, dividend payment or distribution of capital.

Third Party Contracts.

41. Effective immediately, the Association shall not enter into any arrangement or contract with a third party service provider that is significant to the overall operation or financial

condition of the Association¹⁴ or outside the Association's normal course of business unless, with respect to each such contract, the Association has: (a) provided the Regional Director with a minimum of thirty (30) days prior written notice of such arrangement or contract and a written determination that the arrangement or contract complies with the standards and guidelines set forth in Thrift Bulletin 82a (TB 82a); and (b) received written notice of non-objection from the Regional Director.

Brokered Deposits.

42. Effective immediately, the Association shall comply with the requirements of 12 C.F.R. § 337.6(b).

Violations of Law.

43. Within sixty (60) days, the Association shall ensure that all violations of law and/or regulation discussed in the 2010 Examination are corrected and that adequate policies, procedures and systems are established or revised and thereafter implemented to prevent future violations.

Board Oversight of Compliance with Order.

44. Within thirty (30) days, the Board shall designate a committee to monitor and coordinate the Association's compliance with the provisions of this Order and the completion of all corrective actions required in the 2010 Examination (Compliance Committee). The Compliance Committee shall review all of management's corrective actions and make an independent determination of the Association's compliance with this Order. The Compliance Committee

¹⁴ A contract will be considered significant to the overall operation or financial condition of the Association where the annual contract amount equals or exceeds two percent (2%) of the Association's total capital, where there is a foreign service provider, or where it involves information technology that is critical to the Association's daily operations without regard to the contract amount.

shall be comprised of four (4) or more directors, the majority of whom shall be independent¹⁵ directors.

45. Within thirty (30) days after the end of each quarter, beginning with the quarter ending December 31, 2010, the Compliance Committee shall submit a written compliance progress report to the Board (Compliance Tracking Report). The Compliance Tracking Report shall, at a minimum:

- (a) separately list each corrective action required by this and the 2010 Examination;
- (b) identify the required or anticipated completion date for each corrective action; and
- (c) discuss the current status of each corrective action, including the action(s) taken or to be taken to comply with each corrective action; and
- (d) detail the Compliance Committee's determinations regarding the Association's compliance with the Order and completion of all corrective actions required in the 2010 Examination.

46. Within forty-five (45) days after the end of each quarter, beginning with the quarter ending December 31, 2010, the Board shall review the Compliance Tracking Report and all

¹⁵ For purposes of this Order, an individual who is "independent" with respect to the Association shall be any individual who:

- a. is not employed in any capacity by the Association, its subsidiaries, or its affiliates, other than as a director;
- b. does not own or control more than ten percent (10%) of the outstanding shares of the Association or any of its affiliates;
- c. is not related by blood or marriage to any officer or director of the Association or any of its affiliates, or to any shareholder owning more than ten percent (10%) of the outstanding shares of the Association or any of its affiliates, and who does not otherwise share a common financial interest with any such officer, director or shareholder;
- d. is not indebted, directly or indirectly, to the Association or any of its affiliates, including the indebtedness of any entity in which the individual has a substantial financial interest, in an amount exceeding 10 percent (10%) of the Association's total Tier 1 (Core) capital; and
- e. has not served as a consultant, advisor, underwriter, or legal counsel to the Association or any of its affiliates.

reports required by this Order. Following its review, the Board shall adopt a resolution: (a) certifying that each director has reviewed the Compliance Tracking Report and all required reports; and (b) documenting any corrective actions adopted by the Board. A copy of the Compliance Tracking Report and the Board resolution shall be provided to the Regional Director within ten (10) days after the Board meeting.

Effective Date, Incorporation of Stipulation.

47. This Order is effective on the Effective Date as shown on the first page. The Stipulation is made a part hereof and is incorporated herein by this reference.

Duration.

48. This Order shall remain in effect until terminated, modified, or suspended by written notice of such action by the OTS, acting by and through its authorized representatives.

Time Calculations.

49. Calculation of time limitations for compliance with the terms of this Order run from the Effective Date and shall be based on calendar days, unless otherwise noted.

50. The Regional Director, or an OTS authorized representative, may extend any of the deadlines set forth in the provisions of this Order upon written request by the Association that includes reasons in support for any such extension. Any OTS extension shall be made in writing.

Submissions and Notices.

51. All submissions, including any reports, to the OTS that are required by or contemplated by this Order shall be submitted within the specified timeframes.

52. Except as otherwise provided herein, all submissions, requests, communications, consents or other documents relating to this Order shall be in writing and sent by first class U.S.

mail (or by reputable overnight carrier, electronic facsimile transmission or hand delivery by messenger) addressed as follows:

- (a) To the OTS:
Regional Director
Office of Thrift Supervision
1475 Peachtree St., NE
Atlanta, Georgia 30309

- (b) To the Association:
Board of Directors
Harrington Bank, FSB
5925 Farrington Road
Chapel Hill, NC 27517

No Violations Authorized.

53. Nothing in this Order or the Stipulation shall be construed as allowing the Association, its Board, officers, or employees to violate any law, rule, or regulation.

IT IS SO ORDERED.

OFFICE OF THRIFT SUPERVISION

By: _____ /s/
James G. Price
Regional Director, Southeast Region

Date: See Effective Date on page 1

UNITED STATES OF AMERICA
Before the
OFFICE OF THRIFT SUPERVISION

In the Matter of)	Order No.: SE-10-056
)	
HARRINGTON BANK, FSB)	Effective Date: November 23, 2010
)	
Chapel Hill, North Carolina)	
OTS Docket No. 17910)	
)	

STIPULATION AND CONSENT TO ISSUANCE OF ORDER TO CEASE AND DESIST

WHEREAS, the Office of Thrift Supervision (OTS), acting by and through its Regional Director for the Southeast Region (Regional Director), and based upon information derived from the exercise of its regulatory and supervisory responsibilities, has informed Harrington Bank, FSB, Chapel Hill, North Carolina, OTS Docket No. 17910 (Association), that the OTS is of the opinion that grounds exist to initiate an administrative proceeding against the Association pursuant to 12 U.S.C. § 1818(b);

WHEREAS, the Regional Director, pursuant to delegated authority, is authorized to issue Orders to Cease and Desist where a savings association has consented to the issuance of an order; and

WHEREAS, the Association desires to cooperate with the OTS to avoid the time and expense of such administrative cease and desist proceeding by entering into this Stipulation and Consent to the Issuance of Order to Cease and Desist (Stipulation) and, without admitting or

denying that such grounds exist, but only admitting the statements and conclusions in Paragraphs 1 and 2 below concerning Jurisdiction, hereby stipulates and agrees to the following terms:

Jurisdiction.

1. The Association is a “savings association” within the meaning of 12 U.S.C. § 1813(b) and 12 U.S.C. § 1462(4). Accordingly, the Association is “an insured depository institution” as that term is defined in 12 U.S.C. § 1813(c).
2. 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 enforcement proceeding against a savings association. Therefore, the Association is subject to the authority of the OTS to initiate and maintain an administrative cease and desist proceeding against it pursuant to 12 U.S.C. § 1818(b).

OTS Findings of Fact.

3. Based on its June 1, 2010 examination of the Association (2010 Examination), the OTS finds that the Association has engaged in unsafe or unsound banking practices and failed to comply with conditions imposed in writing by the OTS including:
 - (a) operating the Association with an inadequate level of capital protection for the volume, type and quality of assets held by the Association;
 - (b) operating with inadequate earnings to augment capital and support reserves;
 - (c) operating with an excessive level of adversely classified loans and assets;
 - (d) creating and operating with an excessive concentration of commercial real estate and construction loans.
 - (e) operating the Association with a materially underfunded ALLL and inaccurately reported and understated classified assets.

- (f) engaging in unsafe and unsound practices by failing to:
 - (i) provide OTS with an acceptable business plan and capital plan that included reasonable strategies to preserve and enhance capital, improve asset quality, and strengthen and improve earnings;
 - (ii) adopt and implement acceptable Allowance for Loan Lease Loss (ALLL) policies, procedures and methodologies that ensured the timely establishment and maintenance of adequate ALLLs;

4. Based on its 2010 Examination of the Association, the OTS finds that the Association has engaged in violations of law and regulation, including:

- (a) 12 C.F.R. § 560.101 (regarding Real Estate Lending Standards);
- (b) 12 C.F.R. § 560.160 (regarding accurate and timely classification of assets);
- (c) 12 C.F.R. § 563.161 (regarding safe and sound management and financial policies); and
- (d) 12 C.F.R. § 563.170(c) (regarding establishment and maintenance of accurate books and records).

Consent.

5. The Association consents to the issuance by the OTS of the accompanying Order to Cease and Desist (Order). The Association further agrees to comply with the terms of the Order upon the Effective Date of the Order and stipulates that the Order complies with all requirements of law.

Finality.

6. The Order is issued by the OTS under 12 U.S.C. § 1818(b). Upon the Effective Date, the Order shall be a final order, effective, and fully enforceable by the OTS under the provisions of

12 U.S.C. § 1818(i).

Waivers.

7. The Association waives the following:
- (a) the right to be served with a written notice of the OTS's charges against it as provided by 12 U.S.C. § 1818(b) and 12 C.F.R. Part 509;
 - (b) the right to an administrative hearing of the OTS's charges as provided by 12 U.S.C. § 1818(b) and 12 C.F.R. Part 509;
 - (c) the right to seek judicial review of the Order, including, without limitation, any such right provided by 12 U.S.C. § 1818(h), or otherwise to challenge the validity of the Order; and
 - (d) any and all claims against the 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, federal statutes, or otherwise.

OTS Authority Not Affected.

8. Nothing in this Stipulation or accompanying Order shall inhibit, estop, bar, or otherwise prevent the OTS from taking any other action affecting the Association if at any time the OTS deems it appropriate to do so to fulfill the responsibilities placed upon the OTS by law.

Other Governmental Actions Not Affected.

9. The Association acknowledges and agrees that its consent to the issuance of the Order is solely for the purpose of resolving the matters addressed herein, consistent with Paragraph 7 above, and does not otherwise release, discharge, compromise, settle, dismiss, resolve, or in any way affect any actions, charges against, or liability of the Association that arise pursuant to this

action or otherwise, and that may be or have been brought by any governmental entity other than the OTS.

Miscellaneous.

10. The laws of the United States of America shall govern the construction and validity of this Stipulation and of the Order.

11. If any provision of this Stipulation and/or the 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.

12. All references to the OTS in this Stipulation and the Order shall also mean any of the OTS's predecessors, successors, and assigns.

13. The section and paragraph headings in this Stipulation and the Order are for convenience only and shall not affect the interpretation of this Stipulation or the Order.

14. The terms of this Stipulation and of the Order represent the final agreement of the parties with respect to the subject matters thereof, and constitute the sole agreement of the parties with respect to such subject matters.

15. The Stipulation and Order shall remain in effect until terminated, modified, or suspended in writing by the OTS, acting through its Regional Director or other authorized representative.

Signature of Directors/Board Resolution.

16. Each Director signing this Stipulation attests that he or she voted in favor of a Board Resolution authorizing the consent^{of} of the Association to the issuance of the Order and the execution of the Stipulation. This Stipulation may be executed in counterparts by the directors

after approval of execution of the Stipulation at a duly called board meeting.

WHEREFORE, the Association, by its directors, executes this Stipulation.

Accepted by:

HARRINGTON BANK
Chapel Hill, North Carolina

OFFICE OF THRIFT SUPERVISION

By: _____ /s/
Michael J. Giarla
Chairman

By: _____ /s/
James G. Price
Regional Director, Southeast Region

Date: See Effective Date on page 1

_____/s/
Lawrence T. Loeser, Director

_____/s/
Jennifer S. Conrad, Director

_____/s/
Matthew E. Czajkowski, Director

_____/s/
John R. McAdams, Director