

UNITED STATES OF AMERICA  
BEFORE THE  
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON, D.C.

STATE OF WISCONSIN  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
MADISON, WISCONSIN

Written Agreement by and among

ELMWOOD FINANCIAL CORPORATION  
Racine, Wisconsin

BANK OF ELMWOOD  
Racine, Wisconsin

FEDERAL RESERVE BANK OF CHICAGO  
Chicago, Illinois

and

WISCONSIN DEPARTMENT OF  
FINANCIAL INSTITUTIONS  
Madison, Wisconsin

Docket Nos. 08-054-WA/RB-HC  
08-054-WA/RB-SM

WHEREAS, in recognition of their common goal to maintain the financial soundness of Elmwood Financial Corporation, Racine, Wisconsin (“Elmwood”), a registered bank holding company, and its subsidiary bank, Bank of Elmwood, Racine, Wisconsin (the “Bank”), a state chartered bank that is a member of the Federal Reserve System, Elmwood, the Bank, the Federal Reserve Bank of Chicago (the “Reserve Bank”), and the Wisconsin Department of Financial Institutions (the “DFI”) have mutually agreed to enter into this Written Agreement (the “Agreement”); and

WHEREAS, on January 14, 2009, the boards of directors of Elmwood and the Bank, at duly constituted meetings, adopted resolutions authorizing and directing Jess S. Levin to enter into this Agreement on behalf of Elmwood and the Bank, and consenting to compliance with each and every applicable provision of this Agreement by Elmwood, the Bank, and their institution-affiliated parties, as defined in sections 3(u) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the "FDI Act") (12 U.S.C. §§ 1813(u) and (b)(3)).

NOW, THEREFORE, Elmwood, the Bank, the Reserve Bank, and the DFI agree as follows:

### **Board Oversight**

1. Within 60 days of this Agreement, the board of directors of the Bank shall submit to the Reserve Bank and the DFI a written plan to strengthen board oversight of the management and operations of the Bank. The plan shall, at a minimum, address, consider, and include:

(a) The actions that the board of directors will take to improve the Bank's condition and maintain effective control over, and supervision of, the Bank's senior management and major operations and activities, including but not limited to, lending, credit risk management, credit administration, capital, earnings, and funds management;

(b) the responsibility of the board of directors to monitor management's adherence to approved Bank policies and procedures, and to require management to document exceptions thereto;

(c) the establishment of measures to ensure Bank staff's adherence to approved policies and procedures;

(d) a description of the information and reports that will be regularly reviewed by the board of directors in its oversight of the operations and management of the Bank, including information on the Bank's adversely classified assets, allowance for loan and lease losses ("ALLL"), capital, earnings, and liquidity;

(e) the establishment of appropriate written risk tolerance guidelines and risk limits, and controls to ensure adherence thereto;

(f) the establishment of formal tracking and follow-up procedures to ensure corrective actions are taken to address audit and regulatory findings; and

(g) measures to establish a culture of safe and sound lending practices, including, but not limited to, compensation and bonus standards for loan origination officers that include an assessment of loan performance.

### **Management Review**

2. (a) Within 20 days of this Agreement, the board of directors of the Bank shall retain an independent consultant acceptable to the Reserve Bank and the DFI to assess: (i) the Bank's management and staffing needs, with particular emphasis on loan administration and workouts, and funds management; and (ii) the qualifications and performance of all senior executive officers, including their ability to: adhere to applicable laws and regulations and the Bank's established policies and procedures; restore and maintain the Bank to a safe and sound condition; and comply with the requirements of this Agreement (the "Management Review"). The independent consultant shall prepare a written report of findings and recommendations (the "Report").

(b) Within 10 days of the Reserve Bank's and the DFI's approval of the Bank's independent consultant selection, the Bank shall submit an engagement letter to the

Reserve Bank and the DFI for approval. The engagement letter shall require the independent consultant to submit the Report within 30 days of regulatory approval of the engagement letter and to provide a copy of the Report to the Reserve Bank and the DFI at the same time that it is provided to the Bank's board of directors.

3. Within 30 days of receipt of the Report or receipt of all approvals of the Reserve Bank and the DFI required by paragraphs 2(a) and (b) of this Agreement, whichever is later, the Bank's board of directors shall submit a written management plan to the Reserve Bank and the DFI that fully addresses the findings and recommendations in the independent consultant's Report and describes the specific actions that the board of directors proposes to take in order to strengthen the Bank's management and hire, as necessary, additional or replacement officers or staff to properly manage and operate the Bank.

#### **Credit Administration**

4. (a) Within 90 days of this Agreement, the Bank shall take all steps necessary to correct all documentation and credit information deficiencies noted in the report of the examination of the Bank conducted by the DFI that commenced on August 11, 2008 (the "Report of Examination"). In all cases where the Bank is unable to obtain needed documentation or credit information, it shall document in written memoranda the actions taken to secure the information and the reason the information could not be obtained, and shall maintain such documentation in the credit file for subsequent supervisory review.

(b) The Bank shall adopt written procedures designed to ensure the timely receipt of complete loan documentation and to minimize loan documentation exceptions. The Bank shall provide to the Reserve Bank and the DFI a copy of the procedures and a list of resolved document exceptions within 120 days of this Agreement.

## **Asset Improvement**

5. (a) The Bank shall not, directly or indirectly, extend or renew any credit to or for the benefit of any borrower, including any related interest of the borrower, who is obligated to the Bank in any manner on any extension of credit or portion thereof that has been charged off by the Bank or classified, in whole or in part, “loss” in the Report of Examination or in any subsequent report of examination, as long as such credit remains uncollected.

(b) The Bank shall not, directly or indirectly, extend or renew any credit to or for the benefit of any borrower, including any related interest of the borrower, whose extension of credit has been classified “doubtful” or “substandard” in the Report of Examination or in any subsequent report of examination, without the prior approval of the Bank’s board of directors.

The board of directors shall document in writing the reasons for the extension of credit or renewal, specifically certifying that: (i) the extension of credit is necessary to protect the Bank’s interest in the ultimate collection of the credit already granted or (ii) the extension of credit is in full compliance with the Bank’s written loan policy, is adequately secured, and a thorough credit analysis has been performed indicating that the extension or renewal is reasonable and justified, all necessary loan documentation has been properly and accurately prepared and filed, the extension of credit will not impair the Bank’s interest in obtaining repayment of the already outstanding credit, and the board of directors reasonably believes that the extension of credit or renewal will be repaid according to its terms. The written certification shall be made a part of the minutes of the board of directors meetings, and a copy of the signed certification, together with the credit analysis and related information that was used in the determination, shall be retained by the Bank in the borrower’s credit file for subsequent supervisory review. For purposes of this Agreement, the term “related interest” is defined as set forth in section 215.2(n)

of Regulation O of the Board of Governors of the Federal Reserve System (the “Board of Governors”) (12 C.F.R. § 215.2(n)).

6. (a) Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the DFI an acceptable written plan designed to improve the Bank’s position through repayment, amortization, liquidation, additional collateral, or other means on each loan or other asset in excess of \$200,000, including other real estate owned (“OREO”), that (i) is past due as to principal or interest more than 90 days as of the date of this Agreement; (ii) is on the Bank’s problem loan list; or (iii) was adversely classified in the Report of Examination.

(b) Within 30 days of the date that any additional loan or other asset in excess of \$200,000, including OREO, becomes past due as to principal or interest for more than 90 days, is on the Bank’s problem loan list, or is adversely classified in any subsequent report of examination of the Bank, the Bank shall submit to the Reserve Bank and the DFI an acceptable written plan to improve the Bank’s position on such loan or asset.

(c) Within 30 days after the end of each calendar quarter thereafter, the Bank shall submit a written progress report to the Reserve Bank and the DFI to update each asset improvement plan, which shall include, at a minimum, the carrying value of the loan or other asset and changes in the nature and value of supporting collateral, along with a copy of the Bank’s current problem loan list, extension report, and past due/non-accrual report.

#### **Allowance for Loan and Lease Losses**

7. (a) Within 10 days of this Agreement, the Bank shall eliminate from its books, by charge-off or collection, all assets or portions of assets classified “loss” in the Report of Examination that have not been previously collected in full or charged off. Thereafter the Bank shall, within 30 days from the receipt of any federal or state report of examination, charge

off all assets classified “loss” unless otherwise approved in writing by the Reserve Bank and the DFI.

(b) Within 60 days of this Agreement, the Bank shall review and revise its ALLL methodology consistent with relevant supervisory guidance, including the Interagency Policy Statements on the Allowance for Loan and Lease Losses, dated July 2, 2001 (SR 01-17 (Sup)) and December 13, 2006 (SR 06-17), and the findings and recommendations regarding the ALLL set forth in the Report of Examination, and submit a description of the revised methodology to the Reserve Bank and the DFI. The revised ALLL methodology shall be designed to maintain an adequate ALLL and shall address, consider, and include, at a minimum, the reliability of the Bank’s loan grading system, the volume of criticized loans, concentrations of credit, the current level of past due and nonperforming loans, past loan loss experience, evaluation of probable losses in the Bank’s loan portfolio, including adversely classified loans, and the impact of market conditions on loan and collateral valuations and collectibility.

(c) Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the DFI an acceptable written program for the maintenance of an adequate ALLL. The program shall include policies and procedures to ensure adherence to the revised ALLL methodology and provide for periodic reviews and updates to the ALLL methodology, as appropriate. The program shall also provide for a review of the ALLL by the board of directors on at least a quarterly calendar basis. Any deficiency found in the ALLL shall be remedied in the quarter it is discovered, prior to the filing of the Consolidated Reports of Condition and Income, by additional provisions. The board of directors shall maintain written documentation of its review, including the factors considered and conclusions reached by the Bank in determining the adequacy of the ALLL. During the term of this Agreement, the Bank shall submit to the Reserve

Bank and the DFI, within 30 days after the end of each calendar quarter, a written report regarding the board of directors' quarterly review of the ALLL and a description of any changes to the methodology used in determining the amount of ALLL for that quarter.

### **Capital Plan**

8. Within 60 days of this Agreement, Elmwood and the Bank shall submit to the Reserve Bank and the DFI an acceptable written plan to maintain sufficient capital at the Bank. The plan shall, at a minimum, address, consider, and include the Bank's current and future capital requirements, including:

(a) Compliance with the Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure and Tier 1 Leverage Measure, Appendices A and B of Regulation H of the Board of Governors (12 C.F.R. Part 208, App. A and B);

(b) the volume of adversely classified assets;

(c) the adequacy of the ALLL;

(d) any planned asset growth;

(e) the anticipated level of retained earnings;

(f) anticipated and contingent liquidity needs;

(g) the source and timing of additional funds to fulfill the future capital and ALLL needs of the Bank; and

(h) the requirements of section 225.4(a) of Regulation Y of the Board of Governors (12 C.F.R. § 225.4(a)) that Elmwood serve as a source of strength to the Bank.

9. The Bank's board of directors shall monitor and review the sufficiency of the Bank's capital on a monthly basis and shall reflect such reviews in the minutes of the board of directors' meetings.



## **Liquidity and Funds Management**

10. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the DFI an acceptable written plan designed to improve management of the Bank's liquidity position. The plan shall, at a minimum, address, consider, and include:

- (a) Measures to enhance the monitoring and reporting of the Bank's liquidity position;
- (b) measures to diversify funding sources; and
- (c) establishment of meaningful benchmarks for the Bank's liquidity position and risk limits commensurate with the Bank's funding structure.

11. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the DFI an acceptable revised written contingency funding plan that includes, at a minimum:

- (i) analysis of additional liquidity sources; and
- (ii) adverse scenario analyses to assess possible liquidity events that the Bank may encounter and identify responses to the potential impact of such events on the Bank's short-term, intermediate-term, and long-term liquidity profile.

## **Investment Policy**

12. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the DFI an acceptable revised written investment policy that shall, at a minimum, address, consider, and include:

- (a) A description of acceptable and unacceptable types of investments within the categories of permissible investments;
- (b) periodic review of the credit quality of the investment portfolio;
- (c) procedures to mitigate risk and control loss exposure; and

(d) reporting, review, and approval procedures to and by the board of directors.

### **Strategic Plan and Budget**

13. (a) Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the DFI a strategic plan to improve the Bank's earnings and overall condition and a budget for 2009 that shall, at a minimum, shall provide for or describe:

- (i) goals and strategies for improving the Bank's earnings;
- (ii) the responsibilities of the board of directors regarding the definition, approval, implementation, and monitoring of the strategic plan and budget;
- (iii) an identification of the major areas in, and means by which the board of directors and management shall seek to improve the Bank's earnings and operating performance;
- (iv) a realistic and comprehensive budget for calendar year 2009, that includes the operating assumptions that form the basis for, and adequately support, major projected income, expense, and balance sheet components.

(b) A strategic plan and budget for each calendar year subsequent to 2009 shall be submitted to the Reserve Bank and the DFI at least 30 days prior to the beginning of that calendar year.

## **Dividends**

14. (a) Elmwood and the Bank shall not declare or pay any dividends without the prior written approval of the Reserve Bank, the Director of the Division of Banking Supervision and Regulation of the Board of Governors (the “Director”) and, as to the Bank, the DFI.

(b) Elmwood shall not take any other form of payment representing a reduction in capital from the Bank without the prior written approval of the Reserve Bank.

(c) Elmwood and its nonbank subsidiaries shall not make any distributions of interest, principal, or other sums on subordinated debentures or trust preferred securities without the prior written approval of the Reserve Bank and the Director.

(d) All requests for prior approval shall be received at least 30 days prior to the proposed dividend declaration date, proposed distribution on subordinated debentures, and required notice of deferral on trust preferred securities. All requests shall contain, at a minimum, current and projected information, as appropriate, on the parent’s capital, earnings, and cash flow; the Bank’s capital, asset quality, earnings and ALLL needs; and identification of the sources of funds for the proposed payment or distribution. For requests to declare or pay dividends, Elmwood and the Bank, as appropriate, must also demonstrate that the requested declaration or payment of dividends is consistent with the Board of Governors’ Policy Statement on the Payment of Cash Dividends by State Member Banks and Bank Holding Companies, dated November 14, 1985 (Federal Reserve Regulatory Service, 4-877 at page 4-323).

## **Debt and Stock Redemption**

15. (a) Elmwood and its nonbank subsidiaries shall not, directly or indirectly, incur, increase, or guarantee any debt without the prior written approval of the Reserve Bank. All requests for prior written approval shall contain, but not be limited to, a statement regarding

the purpose of the debt, the terms of the debt, and the planned source(s) for debt repayment, and an analysis of the cash flow resources available to meet such debt repayment.

(b) Elmwood shall not, directly or indirectly, purchase or redeem any shares of its stock without the prior written approval of the Reserve Bank and the DFI.

### **Compliance with Laws and Regulations**

16. (a) The Bank shall take all actions necessary to correct the violations of law and regulation cited in the Report of Examination.

(b) In appointing any new director or senior executive officer, or changing the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position, Elmwood the Bank shall comply with the notice provisions of section 32 of the FDI Act (12 U.S.C. § 1831i) and Subpart H of Regulation Y of the Board of Governors (12 C.F.R. §§ 225.71 *et seq.*).

(c) Elmwood and the Bank shall comply with the restrictions on indemnification and severance payments of section 18(k) of the FDI Act (12 U.S.C. § 1828(k)) and Part 359 of the Federal Deposit Insurance Corporation's regulations (12 C.F.R. Part 359).

### **Information Technology and Security**

17. Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank and the DFI an acceptable plan, including timetables, to correct the information technology and security deficiencies noted in the Report of Examination.

### **Compliance with the Agreement**

18. Within 30 days after the end of each calendar quarter following the date of this Agreement, the Bank's board of directors shall submit to the Reserve Bank and the DFI written

progress reports detailing the form and manner of all actions taken to secure compliance with this Agreement and the results thereof.

### **Approval and Implementation of Plans, Program, and Policy**

19. (a) The Bank and, as applicable, Elmwood shall submit written plans, a program, a policy, and an engagement letter that are acceptable to the Reserve Bank and the DFI within the applicable time periods set forth in paragraphs 2(b), 6, 7(c), 8, 10, 11, 12, and 17 of this Agreement. An independent consultant acceptable to the Reserve Bank and the DFI shall be retained in the time period set forth in paragraph 2(a).

(b) Within 10 days of approval by the Reserve Bank and the DFI, the Bank shall adopt the approved plans, program, policy, and engagement letter. Upon adoption, the Bank shall promptly implement the approved plans, program, and policy, and thereafter fully comply with them.

(c) During the term of this Agreement, the approved plans, program, policy, and engagement letter shall not be amended or rescinded without the prior written approval of the Reserve Bank and the DFI.

### **Communications**

20. All communications regarding this Agreement shall be sent to:

(a) Mr. David A. Ward  
Assistant Vice President  
Federal Reserve Bank of Chicago  
230 South LaSalle Street  
Chicago, Illinois 60604

(b) Mr. Michael J. Mach  
Administrator  
Division of Banking  
Wisconsin Department of Financial Institutions  
P.O. Box 7876  
Madison, Wisconsin 53507-7876

- (c) Mr. Jess S. Levin  
Chairman and Chief Executive Officer  
Elmwood Financial Corporation  
Bank of Elmwood  
P.O. Box 081160  
Racine, Wisconsin 53408-1160

**Miscellaneous**

21. Notwithstanding any provision of this Agreement, the Reserve Bank and the DFI may, in their sole discretion, grant written extensions of time to Elmwood and the Bank to comply with any provision of this Agreement.

22. The provisions of this Agreement shall be binding upon Elmwood, the Bank, and their institution-affiliated parties, in their capacities as such, and their successors and assigns.

23. Each provision of this Agreement shall remain effective and enforceable until stayed, modified, terminated, or suspended in writing by the Reserve Bank and the DFI.

24. The provisions of this Agreement shall not bar, estop, or otherwise prevent the Board of Governors, the Reserve Bank, the DFI, or any other federal or state agency from taking any other action affecting Elmwood, the Bank, or any of their current or former institution-affiliated parties and their successors and assigns.

25. Pursuant to section 50 of the FDI Act (12 U.S.C. § 1831aa), this Agreement is enforceable by the Board of Governors under section 8 of the FDI Act (12 U.S.C. § 1818).

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the 20th day of January, 2009.

ELMWOOD FINANCIAL CORPORATION

FEDERAL RESERVE BANK  
OF CHICAGO

By: /s/ Jess S. Levin  
Jess S. Levin  
Chairman and  
Chief Executive Officer

By: /s/ Mark H. Kawa  
Mark H. Kawa  
Vice President

BANK OF ELMWOOD

WISCONSIN DEPARTMENT OF  
FINANCIAL INSTITUTIONS

By: /s/ Jess S. Levin  
Jess S. Levin  
Chairman and  
Chief Executive Officer

By: /s/ Michael J. Mach  
Michael J. Mach  
Administrator