



March 2, 2009

Special Inspector General - TARP
Attn: Mr. Neil Barofsky
1500 Pennsylvania Ave., N.W., Suite 1064
Washington, D.C. 20220

Re: Response to Request Letter Dated February 6, 2009

VIA EMAIL; ORIGINAL VIA U.S. MAIL

Dear Mr. Neil Barofsky,

In response to your letter dated February 6, 2009 (OMB Control No 1505-0212) requesting information about our participation in the TARP Capital Purchase Program, please see the responses below:

1(a) — Anticipated Use of CPP Funds

1st Financial Services Corporation (the Corporation), the parent company of Mountain 1st Bank & Trust Company (the Bank), received \$16,369,000 as a direct equity investment in the Corporation via the Capital Purchase Program (CPP). As an equity investment in the Corporation, the proceeds were anticipated and are being used to fund both current operations of the bank as well as future operations. These funds have made it possible for both the Corporation and the Bank to maintain regulatory capital at or above “well capitalized” thresholds with both the FDIC and the Federal Reserve Bank of Richmond (our primary federal banking regulators) and continue to serve our communities’ lending and depository needs without curtailment.

1(b) — Segregation of CPP Funds

The proceeds received by the Corporation, from the Treasury’s preferred stock investment, were not segregated from other general corporate funds and cannot be, as a practical matter, because cash is by definition, fungible both under General Accepted Accounting Principles and for purposes of regulatory reporting. However, these funds are categorized separately on our general ledger and the CPP investment is identified separately on the Corporation’s balance sheet as preferred stock.

1(c) — Use of CPP Funds to Date

As noted in 1(a) above, the proceeds are being used to fund operations of the bank. The operations supported by CPP funds primarily include the continuation of the Bank’s lending and deposit taking activities. Since November 14, 2008 (date of CPP funding), CPP funds have supported the Bank’s fulfillment of its chartered mission of serving the borrowing needs of our local markets via the issuance of approximately \$53.1 million of new loans, of which \$46.8 million has been fully funded to date.

1(d) — *Expected Use of CPP Funds*

We are deploying, not "spending," the CPP proceeds. The Bank has been one of the fastest growing de novo banks in the United States since its inception in 2004. However, its ability to further serve its customer's borrowing needs is dependent upon acquiring additional capital with which to support increases its loan portfolio. When the Corporation received CPP funding, market conditions had severely limited its ability to raise additional capital in the private equity markets.

Without the purchase of preferred stock through the CPP and given the extreme disruption in the private equity markets, the likely alternative for the Corporation and the Bank would have been to aggressively curtail lending activities and maintain the Bank's loan portfolio at static levels or even reduce existing portfolio levels. However, as a result of the purchase of preferred stock via CPP, we anticipate a net increase in the Corporation's total risk weighted assets of *at least* \$50 million, principally through the generation of new loans, over the next two years.

b(4)

(2) — *Senior Executive Compensation*

The Corporate Governance Committee of the Corporation's and the Bank's Boards of Directors is responsible for the design and implementation of the compensation structure for the executive managers of the companies. As a part of its diligence process, this Committee has retained independent counsel who specializes in bank executive compensation and benefits. The Corporate Governance Committee has reviewed the Bank's executive compensation plans and does not believe they encourage unnecessary or excessive risks and that the Bank's executive compensation practices already meet the Department of Treasury's executive compensation guidelines.

As a condition to participating in the CPP program, all executive employment agreements were modified to comply with TARP guidelines. As a small community bank, executive compensation has historically been well below the current Department of Treasury guidelines. Furthermore, due to the impact of external economic conditions on the earnings performance of the Corporation during 2008, no performance incentive compensation or bonuses of any kind were awarded to any employee of the Corporation or Bank for 2008.

The Corporate Governance Committee will implement any changes that become necessary to comport with the Department of the Treasury's guidelines and these changes will be in effect as long as the CPP funding is outstanding. Our Compensation Committee also will make any compensation changes necessary to comport with the American Recovery and Investment Act.

I, Greg Gibson certify that I have reviewed this response and supporting documents, and, based on my knowledge, this response and the supporting documents do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading.

Regards,

A handwritten signature in black ink, appearing to read 'Greg Gibson', with a long horizontal flourish extending to the right.

Greg Gibson
Chief Executive Officer