BANK OF ANYTOWN

ANYTOWN	**ANY COUNTY**	**ANYSTATE**

Region:	Any Region	Certificate Number:	99999
Examiner-In-Charge:	Sandra E. Smart		
Examination Start Date:	August 01, 2012		
Examination As Of Date:	June 30, 2012		

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All dollar amounts are reported in thousands, unless otherwise indicated.

Uniform Financial Institutions Rating System

	Current Exam	Prior Exam	Prior Exam
Examination Start Date	08/01/2012	11/13/2011 / S	10/21/2010
Examination As Of Date	06/30/2012	09/30/2011	09/30/2010
Composite Rating	**3**	**3**	**3**
Component Ratings:			
Capital	**3**	**2**	**2**
Asset Quality	**4**	**4**	**3**
Management	**3**	**3**	**3**
Earnings	**4**	**4**	**3**
Liquidity	**2**	**2**	**2**
Sensitivity to Market Risk	**2**	**2**	**2**
Information Technology	**2**	**1**	**2**
Trust	**2**	**2**	**2**
Compliance[1]	**2**		
Community Reinvestment Act[1]	**S**		

1 Examination dated xx/xx/xxxx

SUMMARY

The bank remains in less than satisfactory condition. Asset quality is weak, earnings are poor, and management needs to make additional efforts to comply with the outstanding Memorandum of Understanding (MOU). Capital is less than satisfactory in relation to the present risk profile. Liquidity is satisfactory, and sensitivity to market risk is moderate. Information Technology, Trust, Bank Secrecy Act (BSA), and Anti-Money Laundering programs are satisfactorily managed. Compliance and Community Reinvestment Act programs are also satisfactory.

MATTERS REQUIRING BOARD ATTENTION

Examiners identified numerous deficiencies that require the Board's prompt attention. The Board should take immediate action to:

- Review and document its implementation of corrective actions regarding the three outstanding MOU items,
- Approve appropriate definitions for credit grades, and review management's progress in meeting loan-review frequency standards,
- Review management's progress in correcting credit administration deficiencies,
- Revise the budget,
- Update the strategic plan,
- Develop a plan to ensure currency transaction reports (CTRs) are filed in a timely manner, and
- Strengthen internal controls and the independence of the internal audit function.

The Board is reminded of the importance of addressing these weaknesses and its responsibility to respond appropriately to the matters highlighted above. For additional details, refer to related comments included throughout this Report of Examination.

MEMORANDUM OF UNDERSTANDING

The bank entered into a MOU on January 21, 2011, based on the October 21, 2010, FDIC examination findings. Management and the Board have not fully addressed three MOU provisions, including an inadequate Allowance for Loan and Lease Losses (ALLL), significant errors in recent Reports of Condition and Income, and lack of documentation on credit extensions. Refer to the Compliance with Enforcement Actions page for additional details.

ASSET QUALITY - 4

Asset quality remains weak and is the primary impediment to improving the bank's overall financial condition. As reflected on the Examination Data and Ratios page, the volume of adversely classified items has decreased by 12 percent since the prior examination, with the volume of adversely classified loans dropping by 24 percent. Despite these improvements, adverse classifications still represent 84 percent of Tier 1 Capital and the ALLL. Additionally, the volume of Loss classifications increased from $194M at the 2011 examination to $1,015M at the current examination. (Asset Review Date: 6/30/2012.)

Loans

Examination classifications are concentrated in the commercial real estate (CRE) portfolio. Loans adversely classified Loss (portions of three relationships totaling $890M) are CRE loans that were adversely classified Substandard at the prior examination.

Most troubled credits result from liberal lending practices exacerbated by the depressed regional economy, particularly the local fishing industry. In response to past regulatory criticisms, management has taken affirmative steps to strengthen credit administration by tightening overall underwriting standards, strengthening collection efforts, decreasing CRE advance rates from 90 percent to 75 percent, and avoiding financing for speculative real estate acquisition and development projects. Although these actions have longer-term positive implications, present credit quality remains hindered by numerous workout situations and the deterioration of existing credits not previously subject to adverse classification. Additional details regarding trends in the level of adversely classified loans are included on the Analysis of Loans Subject to Adverse Classification page.

Loan Review and Internal Grading System

The defined scope of the internal loan review and grading system is adequate. However, management has been unable to comply with internal review frequency standards due to elevated personnel demands associated with working out problem assets. Additionally, assigned credit grades for several larger credits were inaccurate, as exemplified by the partial Loss classification of the Irma Deat, Ltd., and Last Chance Motel credits. In both cases, the credits were internally rated substandard. Additionally, several credits adversely classified Substandard by examiners were internally rated watch. To address this issue, management should more tightly define all credit grades and ensure they are accurately applied.

President Allie C. Lincoln stated that management would review all grading definitions by year-end 2012, and meet review frequency standards by mid-2013.

Allowance for Loan and Lease Losses

The ALLL is inadequate by at least $325M, primarily due to liberal internal credit grading. Additionally, the ALLL allocation for non-watch list credits is inadequate based upon recent loan loss experience on non-watch list loans. Specifically, the institution's average loss rate on non-watch list loans since 2010 is approximately 0.75 percent; however, management only allocates 0.1 percent for residential mortgages and only 0.5 percent for all other non-watch list loans.

President Lincoln indicated management intends to file amended June 30, 2012, Reports of Condition and Income to address income reporting issues and will include a $325M loan loss provision in the amended filings. She stated management would file the amendments prior to September 30, 2012. President Lincoln initiated a review of the loan grading system during the examination and stated that all existing loss-rate percentages would be reviewed.

Credit Administration

Credit administration, although improving, requires further attention. As detailed on the Assets with Credit Data or Collateral Documentation Exceptions page, the number of loans possessing documentation exceptions remains high. In particular, the following credit administration weaknesses should be promptly addressed:

- *Credit Analysis on Participations Purchased* - The bank does not perform pre-purchase credit analysis on participations purchased. An institution purchasing all or part of a loan should perform the same degree of independent credit analysis as if it were the originator.

- *Inspections and Lien Waivers* - The bank does not perform inspections or obtain mechanic's lien waivers prior to making construction loan advances. It is essential that management perform timely inspections and obtain lien waivers to protect the bank's collateral and lien positions.

- *Rent Rolls* - Loan officers do not obtain rent rolls and vacancy figures on an ongoing basis for loans secured by commercial real estate. Rent roll and vacancy information are essential to monitor these types of loans properly.

- *Lien Perfection* - The institution periodically allows perfected interests in collateral to lapse by not filing timely Uniform Commercial Code continuation statements. An effective tickler system to assist in keeping filings current is necessary to prevent a loss in collateral protection.

President Lincoln stated loan officers would immediately begin performing pre-purchase analyses on participations purchased. She also stated that the volume of documentation deficiencies is primarily due to understaffing and indicated management is in the process of hiring an additional loan clerk to assist in this area.

Other Real Estate (ORE)

Management maintains appropriate policies and procedures for acquiring, holding, and disposing of ORE. However, due to deterioration in existing credits, the dollar volume of adversely classified ORE increased

$535M, or 78 percent, since the previous examination. The ORE portfolio primarily consists of CRE previously written down to fair value. The $100M ORE Loss classification reflected in this Report is based on the recently obtained (August 3, 2012), appraised value of the Rolly property.

<u>Concentrations</u>

Several asset concentrations, including a fishing industry concentration, are listed on the Concentrations page. The concentrations are not criticized due to current risk levels. However, management does not currently have procedures in place to identify and monitor such concentrations. Given the potential for increased risk posed by asset concentrations, the Board of Directors should establish appropriate policies and procedures to ensure these risks are properly identified and monitored.

President Lincoln indicated she would develop procedures for identifying and monitoring concentrations and present them to the Board for its review and approval by year-end 2012.

<u>Disposition of Assets Classified Loss</u>

President Lincoln stated that assets classified Loss totaling $1,015M will be charged off by September 30, 2012.

EARNINGS - 4

Earnings performance remains poor. As detailed on the Analysis of Earnings page of this Report, the bank experienced significant operating losses in 2010 and 2011. Although the bank shows net operating income of $103M for the first six months of 2012, profits are substantially overstated due to inadequate provisions for loan losses. As reflected on the Examination Data and Ratios page, the bank will show a negative 0.58 percent Return on Average Assets, based on a net operating loss of $222M, after amending the June 30, 2012 Call Report for the additional $325M ALLL provision.

The poor earnings performance is a direct result of persistent poor asset quality and increasing ORE levels. The high level of nonperforming assets has weakened interest income, required high ALLL provisions, and increased overhead expenses. Although the volume of nonaccruals and other nonearning assets remain high, the net interest margin for the first six months of 2012 improved from 4.37 percent at year-end 2011 to 4.74 percent as of June 30, 2012. This improvement is primarily the result of management’s ability to maintain average interest rates in the loan portfolio above 5 percent, while reducing the average cost of funds to below 1 percent.

Total Noninterest Expense as a percentage of Average Assets has steadily increased over the last three years and reached 3.82 percent as of June 30, 2012. Overhead expenses are nearly 100 basis points above comparable institutions, primarily due to expenses associated with ORE. Given the composition and level of problem assets, management does not expect ORE-related expenses to diminish in the near future. Overhead expenses will also increase due to the planned hiring of additional lending personnel. However, in an effort to reduce overhead, management plans to close the institution’s only branch office on September 30, 2012.

The 2012 budget forecasts net income of $226M. With the exception of inaccurate assumptions related to the level of provision expense, the budgeting process is adequate and the assumptions used are reasonable. Future profitability is primarily dependent on improved asset quality and controlled overhead expenses.

Chairman of the Board Sean Ratzlaff stated that the directorate and senior management would revise the budget to depict provision expense levels more accurately. He directed President Lincoln to have the revised budget ready for Board review and approval at the November 2012 Board meeting.

MANAGEMENT - 3

The overall performance of senior management and the Board of Directors remains less than satisfactory. The bank's current financial condition is primarily the result of liberal lending policies and poor credit administration practices. As documented in prior examination reports, the present management team aggressively pursued loan growth without regard for prudent lending standards and, ultimately, asset quality. Although initial signs of more prudent loan underwriting and improved credit administration are evident, asset quality remains weak and significant aspects of the credit function remain deficient as discussed in detail under Asset Quality.

Board Supervision

Board minutes indicate that Chairman Ratzlaff and President Lincoln dominate policy discussions and decisions. Board members should ensure they adequately fulfill supervisory responsibilities. For example, Director Michael D. Jones attended only 5 of the 12 Board meetings held since the previous examination. Regular attendance at Board and committee meetings is a prerequisite to fulfilling the duties of a director; directors who are unable to meet this obligation should consider resignation. The absence of formal strategic objectives and the inadequacy of written policies have compounded the difficulties of the bank's directors, particularly the outside directors, in fully discharging their oversight responsibilities.

Director Jones stated that he frequently travels out of town on business; however, he committed to attending Board meetings on a more regular basis.

Apparent Violations

Examiners cited apparent violations of the Treasury Department's Bank Secrecy Act regulations for late CTR filings and the Federal Reserve Board's Regulation O for two insider loans that did not receive full Board approval. An apparent violation of the BSA was also cited at the last FDIC examination, and although the number of late filings has declined, repeat infractions reflect unfavorably on the Board and management. The Board of Directors should implement improved controls and procedures to ensure timely CTR filings and appropriate Regulation O loan approvals.

Chairman of the Board Ratzlaff committed to improve BSA and Regulation O controls and promised future compliance.

Strategic Planning

The 2010 strategic plan has not been maintained and is inconsistent with the present condition of the institution, the regional economy, and the local competitive environment. Specifically, the plan's assumptions do not consider the continuing decline of the local fishing industry, the potential impact of a new commercial bank in town, or the recent merger of two local savings and loan associations. Based on these factors, many of the goals and strategies in the plan are outdated and unrealistic. The Board should revise the current plan to address these factors and conditions.

Chairman Ratzlaff stated that the strategic plan would be reviewed and updated before the end of 2012.

Audit and Internal Control

The audit and internal control functions lack independence. While the scope and frequency of the internal audit program are acceptable, Internal Auditor Jasmine Jackson reports directly to President Lincoln. Since President Lincoln is ultimately responsible for most of the day-to-day operations reviewed by the internal auditor, this situation compromises the independence of the internal audit program. The internal auditor should report directly to the Board of Directors or the Audit Committee of the Board to ensure the independence and effectiveness of the audit function. President Lincoln is also a member of the Audit Committee, which oversees the external audit function. Her presence on the committee further limits audit independence. Several outside directors are qualified to serve on the Audit Committee and it is recommended that the Board strengthen the audit function by limiting committee membership to outside directors.

Several internal control deficiencies are detailed under Item 5 of the Risk Management Assessment section of this Report. While these deficiencies are relatively minor, management incorrectly reported that two of these items were corrected in the response to the last external audit. This error underscores the need for more independence in the audit function.

Chairman of the Board Ratzlaff stated that the Board would consider these recommendations at its next meeting. He also stated the internal control deficiencies would be addressed by the end of 2012.

Reports of Condition and Income

Material errors were noted in the last three quarterly Reports of Condition and Income. In numerous cases, examiners were unable to reconcile bank records with the quarterly filings. The most significant errors relate to inaccurately reported interest and fee income on loans, and the inappropriate inclusion of gains on the sale of repossessed assets in interest and fee income.

Executive Vice President/Cashier John M. Gutierrez stated he will file amended June 30, 2012, Reports of Condition and Income, prior to September 30, 2012, to address these issues.

Bank Secrecy Act

The BSA program is generally satisfactory; however, examiners cited apparent violations of Title 31 C.F.R Chapter X Section 1010.306(a)(1) of the Treasury Department's Bank Secrecy Act regulations. The apparent violations relate to Currency Transaction Reports that were not filed within prescribed periods. Refer to the Violations of Laws and Regulations page for additional details.

President Lincoln indicated procedures would be implemented within 90 days to ensure CTRs are submitted in a timely manner.

Office of Foreign Assets Control (OFAC)

Effective policies, procedures, and controls are in place to ensure satisfactory compliance with OFAC regulations.

CAPITAL - 3

Capital is less than satisfactory in relation to the bank's risk profile. The Adversely Classified Items Coverage Ratio remains high at approximately 84 percent. In addition, after making needed provisions to fund the ALLL adequately, the bank has had net operating losses over the past two and a half years. The existing concentration in fishing industry loans, considering the industry’s current depressed condition and anticipated continuing decline, adds to capital concerns. The Tier 1 Leverage Capital ratio of 7.44 percent, detailed on the Examination Data and Ratios page, reflects current examination adjustments for assets classified Loss and the provision expense needed to fund the ALLL appropriately.

President Lincoln pointed out that dividends have not been paid for five years. She further stated that no dividends would be paid until the Tier 1 Leverage Capital ratio exceeds eight percent and earnings become positive and stable.

LIQUIDITY - 2

The bank’s liquidity position is satisfactory. Asset growth has been minimal since the prior examination and the loan portfolio is shrinking. Management has increased the volume of investments in mortgage-backed securities, with the portfolio maintaining slight appreciation. Non-core funding has increased slightly but management is using these funds appropriately. While liquidity levels and funds management practices are generally satisfactory, management should develop a written funds management policy and a contingency funding plan commensurate with the bank’s risk profile. Off-balance sheet commitments are minimal.

President Lincoln stated a written funds management policy and a contingency funding plan would be developed by March 31, 2013.

SENSITIVITY TO MARKET RISK - 2

Sensitivity to market risk is moderate and risk management practices are satisfactory. Funding sources reasonably match the bank's asset repricing structure, and the loan portfolio includes a high volume of adjustable-rate commercial loans. Over the past two years, depositors have moved funds out of maturing time deposits and into money market demand accounts. Management actively manages rates on these deposits, as the local market is very competitive. The bank does not engage in off-balance sheet derivative activity.

Management regularly monitors the bank's rate sensitivity position using income simulations and an economic value of equity model. Management presents detailed quarterly reports to the Board. However, management and the Board should establish, and monitor compliance with, policy limits that reflect the board’s interest rate risk tolerance.

Chairman of the Board Ratzlaff stated that management and the Board would establish interest rate risk policy limits by year-end 2012.

TRUST - 2

The Trust Department operates in general conformance with the Statement of Principles of Trust Department Management. The Board and management's performance and risk management practices are satisfactory relative to the size of the department and the complexity of trust activities. Only moderate weaknesses are present and within management's ability to correct.

The Board adopted a general Trust Policy, but should consider adding policy criteria regarding environmental reviews of real estate that may be held in current or future trust accounts.

Trust Officer Nancy Hancock agreed to develop such guidance for the Board's consideration by the end of the year.

Account administration is generally in compliance with originating documents. Potential conflicts of interest exist from the trust department using own-bank deposits, as well as from holding stock of the parent holding company and an affiliate in one trust account. Trust Officer Hancock surveys local deposit rates to ensure competitive rates are being paid on deposits, but does not maintain documentation of her surveys.

Trust Officer Hancock stated she would maintain documentation of comparable rates in the future.

Asset management practices are generally satisfactory. All account transactions, including discretionary disbursements, are included in monthly Board reports, and the Board reviews all accounts annually. Management should annually document its needs assessment for each applicable account and/or beneficiary, and indicate whether the account's investment mix is meeting those needs. In addition, three trust accounts use fixed income and/or equity mutual funds. Qualified staff should annually review each mutual fund's investment mix and performance relative to an appropriate benchmark.

Trust Officer Hancock committed to documenting annual needs assessments for each trust account, as well as annual mutual fund reviews.

INFORMATION TECHNOLOGY - 2

Overall IT performance is satisfactory. The IT Steering Committee regularly reviews the performance and controls of the bank's computer center and service providers; however, documentation of the committee's 2011 review of critical service providers was incomplete. Management should appropriately document vendor reviews to ensure key service providers are financially viable, adequately protecting customer data, and meeting service level agreements.

President Lincoln stated management would appropriately document all vendor reviews in the future. She added that management would obtain and analyze financial statements, audit reports, continuity plans and tests, and contractual performance results for all critical service provider reviews.

The current IT risk assessment identifies information assets, threats to information assets and data, and controls to mitigate identified threats. However, management has not estimated the probability or impact of identified threats. To ensure risk assessments are properly supported, management should assess and rate both the probability of occurrence and potential impact of all identified threats.

President Lincoln indicated management would assess and rate the probability of occurrence and potential impact of threats in all IT risk assessments completed after September 31, 2012.

The bank is in substantial compliance with the Interagency Guidelines Establishing Standards for Safeguarding Customer Information set forth in Part 364, Appendix B, of the FDIC Rules and Regulations. However, better documentation of the Board's annual review of the Information Security Program could be achieved by including a copy of the presentation in the official Board packet.

Chairman Ratzlaff indicated the documentation would be made a part of the Board's official records in the future.

MEETING WITH THE DIRECTORATE

A Board of Directors meeting was held on September 18, 2012. All directors were present with the exception of Director Henry P. Herrington. William E. Smith, partner in the bank's auditing firm, was also present. Deputy Commissioner of Banking Cynthia B. Jones represented the State Department of Banking. Field Supervisor James D. Gilmore, Examiner-in-Charge Sandra E. Smart, and Financial Institutions Examiner Monica D. Powers represented the FDIC. All matters listed above were discussed with the Board. Most of the discussion concerned the increase in severity of adverse classifications, the need to improve the ALLL methodology, and management's efforts to improve loan administration procedures. The Directorate and management's commitments for corrective action are noted above. Chairman of the Board Ratzlaff asserted that because of the improvement in the bank's overall condition, the MOU should be removed.

DIRECTORATE RESPONSIBILITY

Each member of the Board of Directors is responsible for reviewing this Report of Examination. Each Director must sign the Signatures of Directors page, which affirms that he or she reviewed the Report in its entirety.

Examiner (Signature)	Reviewing Official (Signature) and Title
Sandra E. Smart	Dale K. Watson, Assistant Regional Director

A Memorandum of Understanding (MOU) between the FDIC and the bank became effective on January 21, 2011. Provisions of the MOU that require further efforts or are of a continuing nature are detailed below.

2(b). The bank shall maintain an adequate Allowance for Loan and Lease Losses.

Based on this examination's findings, the Allowance for Loan and Lease Losses is underfunded by at least $325M. Refer to the Examination Conclusions and Comments (ECC) page of this Report for details.

3(a). The bank shall maintain a Tier 1 Leverage Capital ratio at or in excess of seven percent.

As of June 30, 2012, the Tier 1 Leverage Capital ratio approximates 7.44 percent based on management's planned amendments to the Call Reports.

3(d). The bank shall comply with the FDIC's Statement of Policy on Risk-Based Capital.

As of June 30, 2012, the Total Risk-Based Capital ratio is 11.75 percent, and the Tier 1 Risk-Based Capital ratio is 10.48 percent.

4. The bank shall file accurate Call Reports.

Examiners noted significant errors in the December 31, 2011, and the March 31 and June 30, 2012, Call Reports which require amendments. Refer to the ECC page for details.

5. The bank shall not extend or renew, directly or indirectly, credit to, or for the benefit of, any borrower who has a loan or other extension of credit with the bank that has been charged off or classified, in whole or in part, Loss, Doubtful, or Substandard, unless rationale for the extension is noted in the official Board minutes and the appropriate credit file.

On January 30, 2012, the bank extended a $50M loan to U. R. Worth. The borrower was adversely classified Loss at the previous examination. The Board did not specifically document the reason(s) for the extension in the official Board minutes or in the appropriate credit file.

6. The bank shall not declare or pay any dividends without the written consent of the FDIC.

No dividends have been declared or paid since the previous examination.

1. Are risk management processes adequate in relation to economic conditions and asset concentration levels?

No. The Board's strategic plan is outdated and unrealistic. In addition, management makes no effort to monitor asset concentrations. A concentration of credit in the fishing industry, which is projected to remain depressed for the foreseeable future, is listed on the Concentrations page of this Report. Recommendations to improve oversight practices are included on the ECC pages.

2. Are risk management policies and practices for the credit function adequate?

No. Internal credit review and grading are weak, and credit administration practices are deficient. Recommendations for improvement are included under Asset Quality on the ECC page. Additionally, although the bank's loan policy is generally adequate, it does not address the following matters:

- *Participation Loans* - The bank regularly purchases loans or portions of loans from other institutions. These specialized lending activities are not covered in the loan policy.

- *Construction Loans* - The bank finances the construction of 1-4-family residences. While practices are generally adequate, the policy lacks specific guidelines pertaining to construction lending. President Lincoln was provided with a detailed list of issues that should be considered.

- *Environmental Risk* - An environmental risk policy is nonexistent. Examiners provided FDIC environmental-risk program guidelines to management.

President Lincoln stated that management would develop guidelines for purchased loans and construction lending and revise the loan policy by December 31, 2012. She further stated management is currently developing an environmental risk policy.

3. Are risk management policies and practices for asset/liability management and the investment function adequate?

Generally, yes. Management's liquidity management practices are generally adequate; but does not have a written funds management policy or a contingency funding plan. These deficiencies are discussed more fully on the ECC page in the Liquidity comment.

Investment policy guidelines are adequate; however, management's adherence to its written investment policy is inconsistent. On at least three occasions since the previous examination, President Lincoln exceeded her purchasing authority when she purchased securities over $250M without prior Board approval.

The Board should ensure management purchases investments in conformance with existing policy standards or determine if it would be prudent to revise the standards to meet purchasing needs.

President Lincoln stated that she was presented with the opportunity to purchase these securities at a good price and could not wait for Board approval. She further stated she would comply with the policy in the future or discuss modifying the policy with the Board at the next Board meeting.

4. Are risk management processes adequate in relation to, and consistent with, the institution's business plan, competitive conditions, and proposed new activities or products?

No. The strategic plan is outdated. Refer to comments under Management on the ECC page.

5. Are internal controls, audit procedures, and compliance with laws and regulations adequate (includes compliance with the Bank Secrecy Act [BSA] and related regulations)?

No. As indicated under Management on the ECC page, apparent violations of Bank Secrecy Act regulations and Regulation O are cited during this examination. Full details of these citations can be found on the Violations of Laws and Regulations page. In addition, the audit and internal control functions lack independence.

Internal Controls

Examiners noted the following weaknesses in the bank's system of internal controls:

- *Joint Custody of Negotiable Collateral* – The bank does not maintain joint custody over negotiable collateral. Several bearer bonds are maintained in a dual-lock drawer in the vault; however, both keys to the drawer are readily accessible to tellers. The bank's external certified public accountant also noted this deficiency in her December 2011 audit. Management should implement an effective system of joint custody.

- *Vacation Policy* – The bank's vacation policy requires employees to be absent from their normal duties for an uninterrupted period of two weeks each calendar year. Executive Vice President Leslie S. Commander did not remain absent during her two-week vacation in 2011 as she returned daily to reconcile the Federal funds sold account. Management is strongly encouraged to enforce its policy, particularly for employees who are responsible for sensitive transactions.

- *Reconcilement of Correspondent Bank Accounts* – Management has not reconciled the correspondent bank accounts for the past three months. While personnel reconciled these accounts during the examination, they should be reconciled at least monthly.

President Lincoln stated she would take action to address these deficiencies before year-end.

6. Is Board supervision adequate, and are controls over insider transactions, conflicts of interest, and parent/affiliate relationships acceptable?

No. Board supervision is less than satisfactory. Numerous underwriting weaknesses and credit administration deficiencies remain uncorrected from prior examinations, and the Board has not established an effective independent internal audit function. Refer to comments under Management on the ECC page for more details. Additionally, examiners cited two loans as apparent violations of Federal Reserve Regulation O because management did not obtain prior approval on loans to the related interests of President Lincoln and Director Larry G. Killingbird. Refer to the Violations of Laws and Regulations page of this Report for details.

BANK SECRECY ACT

Title 31 C.F.R Chapter X Section 1010.306(a)(1) of the Treasury Department's Bank Secrecy Act regulations requires a covered financial institution to file a Currency Transaction Report (FinCEN Form 104) within the prescribed period.

Examiners identified numerous instances where CTRs were not filed within the required 15-day period. This infraction was also cited at the previous FDIC examination. Between October 2011 and July 2012, 289 of 944 CTRs (31 percent) were filed late. In many cases, CTRs were signed by the approving official more than 15 days after the transaction date. The time between the transaction date and receipt by the Treasury Department on these late filings was generally around 20 to 25 days, with a few exceeding 70 days.

BSA Officer Donna Ludlow stated that some of the late CTRs were filed after an internal audit noted that the forms had not been submitted; however, she could offer no explanation as to why the remaining CTRs were filed late. President Lincoln stated that new procedures would be implemented within 90 days to ensure all CTRs are submitted in a timely manner in the future.

PRIOR BOARD APPROVAL OF INSIDER LOANS – REGULATION O

The Federal Reserve Board's Regulation O, which implements Section 22(h) of the Federal Reserve Act and is made applicable to insured nonmember institutions by Section 18(j)(2) of the Federal Deposit Insurance Act covers transactions with bank insiders. Section 215.4(b)(1) of Regulation O requires extensions of credit by an institution to a director or related interest exceeding the greater of $25M or five percent of unimpaired capital and surplus to have prior approval of the institution's board of directors.

The bank is in apparent violation of this section for extending the following loans with the prior approval of the Executive Loan Committee, which is composed of only three Board members, rather than prior approval by the full Board.

Borrower	Date of Note	Original Amount
Lincoln, Allie C.	12/11/2011	$500M
Any Body, Inc. (A related interest of President Lincoln and Director Killingbird.)	12/28/2011	$250M

President Lincoln stated that these exceptions were the result of oversight. She further indicated that bank policy requires that all insider loans receive the prior approval of the full Board. Examiners noted that all other insider loans received prior Board approval. President Lincoln and the Board of Directors promised future compliance.

ASSET QUALITY		ADVERSELY CLASSIFIED			
		Substandard	Doubtful	Loss	Total
Loans and Leases		4,290	140	890	5,320
Securities		45			45
Other Real Estate Owned		1,125		100	1,225
Other Assets				25	25
Other Transfer Risk					
Subtotal		5,460	140	1,015	6,615
Contingent Liabilities		230			230
Totals at Exam Date	06/30/2012	5,690	140	1,015	6,845
Totals at Prior Exam	09/30/2011	7,345	220	194	7,759
Totals at Prior Exam	09/30/2010	6,655	177	67	6,899

	Exam Date 06/30/2012	Prior Exam 09/30/2011	Prior Exam 09/30/2010
Total Special Mention	354	515	
Adversely Classified Items Coverage Ratio	84.41	102.71	94.92
Total Adversely Classified Assets/Total Assets	8.21	9.93	8.20
Past Due and Nonaccrual Loans and Leases/Gross Loans and Leases	6.76	8.42	9.12
Adversely Classified Loans and Leases/Total Loans	9.86	12.68	11.30
ALLL/Total Loans and Leases	3.67	3.18	2.50

CAPITAL	Exam Date 06/30/2012	Prior Exam 09/30/2011	Prior Exam 09/30/2010
Tier 1 Leverage Capital/Average Total Assets (1)	7.44	7.55	7.67
Tier 1 Risk-Based Capital/Risk-Weighted Assets	10.48	9.88	9.90
Total Risk-Based Capital/Risk-Weighted Assets	11.75	11.39	11.40
Capital Category			
The capital category relates only to the Prompt Corrective Action provisions of Part 325 of the FDIC Rules and Regulations. PCA Categories: W – Well-capitalized, A – Adequately capitalized, U – Undercapitalized, S – Significantly undercapitalized, C – Critically undercapitalized	W	W	W

	Period Ended 06/30/2012	Peer 06/30/2012	Period Ended 12/31/2011	Period Ended 12/31/2010
Retained Earnings/Average Total Equity	3.39	9.32	(2.05)	(3.86)
Asset Growth Rate	2.66	6.78	0.42	0.20
Cash Dividends/Net Income		32.65		

EARNINGS	Period Ended 06/30/2012	Peer 06/30/2012	Period Ended 12/31/2011	Period Ended 12/31/2010
Net Income (After Tax)/Average Assets (1)	(0.58)	1.03	(0.15)	(0.30)
Net Interest Income (TE)/Average Earning Assets	4.74	4.64	4.37	4.64
Total Noninterest Expense/Average Assets	3.82	2.90	3.62	3.54

LIQUIDITY	Period Ended 06/30/2012	Peer 06/30/2012	Period Ended 12/31/2011	Period Ended 12/31/2010
Net Non-Core Funding Dependence New $100M	12.23	10.35	14.67	9.63
Net Non-Core Funding Dependence New $250M *	64.45	66.20	68.79	69.24
Net Loans and Leases/Assets	57.69	52.47	51.60	68.21

(1) 6/30/10 Ratio reflects management's planned $325M adjustment to the ALLL.

* Ratio reflects time deposits exceeding the $250M deposit insurance limit as non-core funding; data not collected prior to 3/31/10.

ASSETS	06/30/2012	12/31/2011
Total Loans and Leases	53,931	55,545
Less: Allowance for Loan & Lease Losses	1,979	1,748
Loans and Leases (net)	51,952	53,797
Interest-Bearing Balances	20	
Federal Funds Sold and Securities Purchased Under Agreements to Resell	4,000	9,100
Trading Account Assets		
Securities: Held-to-Maturity (at Amortized Cost)	2,787	5,993
Available-for-Sale (at Fair Value)	10,888	
Total Earning Assets	**69,647**	**68,890**
Cash and Noninterest-Bearing Balances	5,895	4,743
Premises and Fixed Assets	2,530	2,709
Other Real Estate Owned	1,225	690
Intangible Assets		
Other Assets	1,307	1,175
TOTAL ASSETS	**80,604**	**78,207**
LIABILITIES		
Deposits	67,815	66,221
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	441	516
Other Borrowed Money	5,857	5,136
Other Liabilities	301	307
Subordinated Notes and Debentures		
Total Liabilities	**74,414**	**72,180**
Minority Interest in Consolidated Subsidiaries		
EQUITY CAPITAL		
Perpetual Preferred Stock		
Common Equity Capital	6,190	6,027
Includes net unrealized holding gains (losses) on available-for-sale securities.		
Other Equity Capital		
Total Equity Capital	**6,190**	**6,027**
TOTAL LIABILITIES, MINORITY INTERESTS, AND EQUITY CAPITAL	**80,604**	**78,207**
OFF-BALANCE SHEET ITEMS		
Unused Commitments	4,333	5,893
Letters of Credit	209	824
Other Off-Balance Sheet Items		
Other Derivative Contracts		
Appreciation (Depreciation) in Held-to-Maturity Securities	56	

Footnotes:

Date: 06/30/2012

Category:	Amount	Percent
Real Estate Loans	21,938	40.53
Installment Loans	7,058	13.04
Credit Card and Related Plans	90	0.17
Commercial Loans	22,292	41.18
All Other Loans and Leases	2,753	5.09
Gross Loans and Leases	54,131	100.00

PAST DUE AND NONACCRUAL LOANS AND LEASES

Date: 06/30/2012

Category	Past Due 30 through 89 Days and Accruing	Past Due 90 Days or More and Accruing	Total Past Due and Accruing	Percent of Category	Nonaccrual	Nonaccrual Percent of Category
Real Estate Loans	800	44	844	3.85	1,402	6.39
Installment Loans	125		125	1.77	107	1.52
Credit Card and Related Plans	3		3	3.33		
Commercial and All Other Loans and Leases	626		626	2.50	554	2.21
Totals	1,554	44	1,598	2.95	2,063	3.81
Memorandum Restructured Loans and Leases Included in the Above Totals						

Footnotes:

Description	HELD-TO-MATURITY		AVAILABLE-FOR-SALE	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. Treasury Securities	1,537	1,593		
U.S. Government Agency Obligations				
Issued by U.S. Gov't Agencies			2,550	2,554
Issued by U.S. Gov't-sponsored Agencies				
Issued by States & Political Subdivisions	250	250		
Mortgage-backed Securities (MBS)				
Pass-through Securities:				
Guaranteed by GNMA			7,322	7,415
Issued by FNMA and FHLMC				
Other pass-through securities				
Other MBS (include CMOs & REMICs):				
Issued or Gtd. by FNMA, FHLMC, or GNMA				
Collateralized by MBS Issued or Gtd. by FNMA, FHLMC, or GNMA				
All Other Mortgage-Backed Securities				
Asset-backed Securities (ABS)				
Credit Card Receivables				
Home Equity Lines				
Automobile Loans				
Other Consumer Loans				
Commercial and Industrial Loans				
Other				
Other Debt Securities				
Other Domestic Debt Securities				
Foreign Debt Securities	1,000	1,000		
Equity Securities				
Investments in Mutual Funds and Other Equity Securities with Readily Determinable Fair Values			919	919
Totals:	2,787	2,843	10,791	10,888

SECURITIES APPRECIATION (DEPRECIATION)

Description	Held-to-Maturity	Available-for-Sale	Total
Securities Appreciation (Depreciation)	56	97	153
As a Percent of Amortized Cost	2.01	0.90	1.13

Footnotes:

Includes assets and off-balance sheet items which are detailed in the following categories:
Substandard Assets - A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.
Doubtful Assets - An asset classified Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.
Loss Assets - An asset classified Loss is considered uncollectible and of such little value that continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future.

	CATEGORY		
AMOUNT, DESCRIPTION AND COMMENTS	Substandard	Doubtful	Loss

Note: Ensure write-ups are consistent with the RMS Manual of Examination Policies and ROE Instructions.

LOANS

	Substandard	Doubtful	Loss
500 (1) Nonaccrual 96 Days Past Due			
250 (2) Nonaccrual 96 Days Past Due			
750	750		

AMHILL TOOL & DIE, INC.
By: Robert E. Hill, President
Gty: Roger S. Barrett

Amhill Tool & Die, Inc. manufactures custom plastic-forming dies and provides injection-molding services.

(1) Note originated 1/7/08 at $500M to refinance a $450M mortgage on the obligor's manufacturing plant and provide $50M working capital. The note matures 1/7/15 and requires interest-only payments, with principal due on demand. (2) Term note originated 6/10/09 at $280M, matures 6/11/16, and was extended to refinance a working capital note at another financial institution. The primary source of repayment for both notes is operating cash flow.

The loans are cross collateralized by a first mortgage on the manufacturing plant, located in Anytown, Anystate, and a first security interest in all business assets. A 12/7/07 appraisal reflects a property value of $625M; however, the valuation appears stale given downward trends in local real estate values. As of 12/31/11, management estimated the value of account receivables and inventory at $100M and assigned an estimated liquidation value of $125M to machinery and equipment. Reliance on the machinery and equipment as a secondary repayment source is restricted by their highly specialized nature and limited marketability.

Amhill Tool & Die, Inc. has been negatively impacted by cancelled contracts and high employee turnover. Weak cash flows have caused on-going delinquency problems and management placed the notes on nonaccrual on 3/31/12. The obligor's 12/31/11 income statement reported gross income of $800M and a net operating loss of $100M. Gross sale revenues declined steadily since year-end 2008, and operating losses of $123M and $234M were reported as of 12/31/09 and 12/31/10, respectively. Net worth declined to $125M at year-end 2011, and debt service coverage was calculated at 0.91 times as of 12/31/11. The guarantor's 12/31/10 personal financial statement reflects liquid assets of $30M, a net worth of $375M, and total assets of $890M centered in his ownership interest in Amhill Tool & Die, Inc.

EVP/SLO Commander indicated managerial conflicts contributed to the loss of several lucrative contracts and numerous highly trained employees; however, he stated production output is increasing due to the addition of two knowledgeable managers and improved employee training. He also stated management intends to obtain a new property appraisal, restructure the notes to better match the corporation's cash flows, and to require principal and interest payments on the modified mortgage note.

AMOUNT, DESCRIPTION AND COMMENTS	Substandard	CATEGORY Doubtful	Loss

Debts classified Substandard based on inadequate cash flows, continuing delinquencies, and marginal collateral protection.

Internal Rating: 6 (Watch)
Originating/Servicing Officer: Commander
Examiner: T. Hinojosa

AMOUNT, DESCRIPTION AND COMMENTS	Substandard	Doubtful	Loss
340 BOND, JAMES	200	140	
1,250 IRMA DEAT, LTD.	750		500
290 KRING, CHRISTOPHER Gty: Sam Kring, Inc.	290		
865 LAST CHANCE MOTEL, INC.	500		365
275 RABBIT, PETER	250		25
1,550 EIGHT LOANS LESS THAN $250,000 List left with management.	1,550		
TOTAL ADVERSELY CLASSIFIED LOANS	4,290	140	890

SECURITIES

AMOUNT, DESCRIPTION AND COMMENTS	Substandard	Doubtful	Loss
45 ANYCOUNTY MUNICIPAL GENERAL OBLIGATION	45		
TOTAL ADVERSELY CLASSIFIED SECURITIES	45		

Items Subject to Adverse Classification (Continued)			**99999**
		CATEGORY	
AMOUNT, DESCRIPTION AND COMMENTS	Substandard	Doubtful	Loss
OTHER REAL ESTATE OWNED			
550 ONE WAY HOME, INC. PROPERTY	550		
675 ROLLY PROPERTY	575		100
TOTAL ADVERSELY CLASSIFIED ORE	1,125		100
OTHER ASSETS			
25 SUN, RAYMOND Repossessed Heavy Equipment			25
TOTAL ADVERSELY CLASSIFIED OTHER ASSETS			25
CONTINGENT LIABILITIES			
230 KRING, CHRISTOPHER Amount represents unfunded portion of loan commitment for construction of a single-family residence.	230		
TOTAL ADVERSELY CLASSIFIED CONTINGENT LIABILITIES	230		
TOTAL ADVERSELY CLASSIFIED ITEMS	5,690	140	1,015

Items Listed for Special Mention	99999

Includes assets and off-balance sheet items which are detailed as follows:
Special Mention Assets – A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

DESCRIPTION	AMOUNT

Note: Ensure write-ups are consistent with the RMS Manual of Examination Policies and ROE Instructions.

LOANS

354 RAIN, ROBERT	354
TOTAL LOANS LISTED FOR SPECIAL MENTION	354

Analysis of Loans Subject to Adverse Classification | 99999

DESCRIPTION	SUBSTANDARD	DOUBTFUL	LOSS	TOTAL
Book Value at Last Examination: 09/30/2011	6,641	220	176	7,037
Reductions:				
Payments	1,030	58		1,088
Not Now Adversely Classified	955	162		1,117
Now Classified Substandard				
Now Classified Doubtful	140			140
Now Classified Loss	890			890
To Other Real Estate or Other Assets				
Charged-Off	209		176	385
TOTAL REDUCTIONS	3,224	220	176	3,620
Additions:				
Not Adversely Classified Previously Further Advances - Loans	873			873
Not Adversely Classified Previously Further Advances - Loans Adversely Classified Previously				
Credits Newly Extended				
Previously Classified Substandard		140	890	1,030
Previously Classified Doubtful				
Previously Classified Loss				
TOTAL ADDITIONS	873	140	890	1,903
Book Value at This Examination: 06/30/2012	4,290	140	890	5,320

Analysis of Other Real Estate Owned Subject to Adverse Classification	**99999**

DESCRIPTION	SUBSTANDARD	DOUBTFUL	LOSS	TOTAL
Book Value at Last Examination: 09/30/2011	672		18	690
Reductions:				
Not Now Adversely Classified				
Sales With Outside Financing				
Sales With Financing Provided By Subject Institution				
Now Classified Substandard				
Now Classified Doubtful				
Now Classified Loss	100			100
Charged-Off			18	18
TOTAL REDUCTIONS	100		18	118
Additions:				
Not Adversely Classified Previously	550			550
Further Advances - ORE or Loans Not Adversely Classified Previously				
Transferred from Previously Adversely Classified Loans				
Further Advances - ORE or Loans Adversely Classified Previously	3			3
ORE From Credits Newly Extended				
Previously Classified Substandard ORE			100	100
Previously Classified Doubtful ORE				
Previously Classified Loss ORE				
TOTAL ADDITIONS	553		100	653
Book Value at This Examination: 06/30/2012	1,125		100	1,225

Assets with Credit Data or Collateral Documentation Exceptions	99999

This Page includes assets with technical defects not corrected during the examination. The appropriate number or description is noted in the "Deficiency Description" column.

1 - Appraisal
2 - Title Search or Legal Opinion
3 - Borrowing Authorization
4 - Recordation
5 - Insurance
6 - Collateral Assignment
7 - Financial Statement
8 - Inadequate Income/Cash Flow Information
9 - Livestock Inspection
10 - Crop Inspection

Name or Description	Amount	Date of Most Recent Financial Statement	Deficiency Description
LOANS			
AMHERST, MARY	400	None	7
BODY, CHARLES	1,932	12/31/10	7
C&C MARINA	1,973	06/30/10	7
GOETZ, MICHAEL	1,538	None	1
IRMA DEAT, LTD.	750		4, 6
JENNINGS, JENNIFER	1906		5, 6
KRING, CHRISTOPHER	290		4, 5, 6
Gty: Sam Kring		None	7
LAST CHANCE MOTEL, INC.	500		3, 4, 6
TOTAL	9,289		

Total represents 33 percent of the dollar volume of loans reviewed.

Name or Description	Amount	Date of Most Recent Financial Statement	Deficiency Description
OTHER REAL ESTATE OWNED			
ONE WAY HOME, INC. PROPERTY	550		5
TOTAL	550		

Total represents 45 percent of the dollar volume of ORE reviewed.

Concentrations	99999

Listed below are concentrations of obligations, direct and indirect, according to the following guidelines: 1) Asset concentrations of 25% or more of Tier 1 Capital by individual borrower, small interrelated group of individuals, single repayment source or individual project; 2) Concentrations of 100% or more of Tier 1 Capital by industry, product line, type of collateral, or short term obligations of one financial institution or affiliated group. Any other concentrations may be listed in the 25% category if desired. An appropriate percentage of total assets is used when a bank's capital is so low as to make its use meaningless. U.S. Treasury securities, obligations of U.S. Government agencies and corporations, and any assets collateralized by same are not scheduled.

DESCRIPTION	DETAIL	AMOUNT EXTENDED
CORRESPONDENT BANK CONCENTRATIONS		
FIRST NATIONAL BANK Anothercity, Anotherstate		
Due From Account	3,025	
Federal Funds Sold	4,000	
		7,025
This concentration represents 124 percent of Tier 1 Capital.		
CREDIT CONCENTRATION		
John and Mary Smith Relationship		
John Smith		
Consumer installment	75	
John and Mary Smith		
RE mortgage	275	
JMS Corporation		
JM: John and Mary Smith		
Secured commercial loans (3)	685	
Commercial letters of credit (2)	215	
J&M Realty Trust		
Gty: John and Mary Smith		
Commercial RE mortgage	700	
		1,950
This concentration represents 34 percent of Tier 1 Capital.		
INDUSTRY CONCENTRATION		
Shellfish Fishing Industry (NAICS Code 114112)		8,694
This amount is composed of 49 loans to fishing industry-related borrowers. Repayment of these loans is dependent upon the same sources of income and upon extension of fishing rights granted in the Georges Bank by the Canadian Department of Fisheries, which expire in 2013. The industry concentration represents 153 percent of Tier 1 Capital.		

<u>Tier 1 Capital</u>		
Perpetual Preferred Stock and Related Surplus		
Common Stock	2,955	
Surplus	3,072	
Retained Earnings	103	
Accumulated Other Comprehensive Income and Other Equity Capital Components	60	
Total Equity Capital	6,190	
Net Unrealized Gains (Losses) on Available-For-Sale Securities (if a gain, deduct from Total Equity Capital in the calculation of Tier 1 Capital, if a loss, add it to Total Equity Capital)	60	
Less: Net Unrealized Losses on Available-For-Sale Equity Securities		
Accumulated Net Gains (Losses) on Cash Flow Hedges (if a gain, deduct from Total Equity Capital in the calculation of Tier 1 Capital, if a loss, add it to Total Equity Capital)		
Less: Nonqualifying Perpetual Preferred Stock		
Qualifying Minority Interest in Consolidated Subsidiaries		
Less: Disallowed Goodwill and Other Disallowed Intangible Assets		
Less: Disallowed Servicing Assets and Purchased Credit Card Relationships		
Less: Disallowed Deferred Tax Assets		
Other Additions to (Deductions from) Tier 1 Capital		
Subtotal: Tier 1 Capital Elements	6,130	
Less: Assets Other Than Loans & Leases Classified Loss	125	
Less: Additional Amount to be Transferred to Tier 2 for Inadequate Allowance for Loan and Lease Losses	325	
Other Adjustments to (from) Tier 1 Capital (1)		
Tier 1 Capital		5,680
<u>Tier 2 Capital</u>		
Qualifying Subordinated Debt and Redeemable Preferred Stock		
Cumulative Perpetual Preferred Stock Includible in Tier 2 Capital		
Allowance for Loan & Lease Losses	1,979	
Less: Loans & Leases Classified Loss	890	
Add: Amount Transferred from Tier 1 Capital	325	
Adjusted Allowance for Loan & Lease Losses	1,414	
Less: Ineligible Portion of Allowance (If Applicable)	728	
Allowance for Loan and Lease Losses Includible in Tier 2 Capital	686	
Unrealized Gains on Available-For-Sale Equity Securities Includible in Tier 2 Capital		
Other Tier 2 Capital Components		
Other Adjustments to (from) Tier 2 Capital		
Tier 2 Capital (Not to Exceed 100% of Tier 1 Capital)		686
Tier 3 Capital Allocated for Market Risk (Tier 3 Plus Tier 2 Not to Exceed 100% of Tier 1 Capital)		
Less: Deductions for Total Risk-Based Capital (1)		
Total Capital		6,366
<u>Risk-Weighted Assets and Average Total Assets Calculations</u>		
Risk-Weighted Balance Sheet Items	55,761	
Risk-Weighted Off-balance Sheet Items	159	
Market Risk Equivalent Assets		
Less: Risk-Weighted Amounts Deducted from Capital	1,015	
Gross Risk-Weighted Assets		54,905
Less: Ineligible Portion of ALLL & ATRR (1)	728	
Total Risk-Weighted Assets		54,177
Average Total Assets (From 06/30/04 Call Report Schedule RC-K)	76,803	
Less: Amounts Deducted from Tier 1 Capital (1)	450	
Adjusted Average Total Assets		76,353
<u>MEMORANDA</u>		
Securities Appreciation (Depreciation)		153
Contingent Liabilities/Potential Loss	4,542/	

Footnotes:

(1) Includes adjustment for financial subsidiaries as defined by the Gramm-Leach-Bliley Act of 1999, if applicable.

Comparative Statement of Income

	Period Ended 06/30/2012	Period Ended 12/31/2011	Period Ended 12/31/2010
Interest Income	2,519	5,582	7,329
Interest Expense	894	2,452	3,850
Net Interest Income	1,625	3,130	3,479
Noninterest Income	304	589	643
Total Noninterest Expense	1,467	2,902	2,904
Provision for Loan and Lease Losses	300	1,025	1,580
Securities Gains (Losses)	15	48	
Net Operating Income (Pre-Tax)	177	(160)	(362)
Applicable Income Taxes	74	(36)	(117)
Net Operating Income (After-Tax)	103	(124)	(245)
Extraordinary Credits (Charges), Net			
Net Income	103	(124)	(245)
Other Increases/Decreases *Includes changes in the net unrealized holding gains (losses) on Available-For-Sale Securities*	60		
Cash Dividends			
Net Change in Equity Accounts	163	(124)	(245)

Reconcilement of Allowance for Loan and Lease Losses

	Period Ended 06/30/2012	Period Ended 12/31/2011	Period Ended 12/31/2010
Beginning Balance	1,748	1,407	950
Gross Loan and Lease Losses	181	884	1,274
Recoveries	112	200	151
Provision for Loan and Lease Losses	300	1,025	1,580
Other Increases (Decreases)			
Ending Balance	1,979	1,748	1,407

Other Component Ratios and Trends

Ratio	Period Ended 06/30/2012	Period Ended 12/31/2011	Period Ended 12/31/2010
Net Interest Income (TE)/Average Earning Assets	4.74	4.37	4.64
Total Noninterest Expense/Average Assets	3.82	3.62	3.54
Net Income/Average Total Equity	3.39	(2.05)	(3.87)
Net Losses/Average Total Loans and Leases	.025	1.24	1.88
Earnings Coverage of Net Losses (X)	6.70	(1.19)	(1.08)
ALLL/Total Loans and Leases	3.67	3.15	2.50
Noncurrent Loans and Leases/ALLL	106.47	143.88	100.64

Footnotes:

Comparative Statements of Income and Changes in Equity Capital Accounts	99999

ITEMS	06/30/2012	12/31/2011	12/31/2010
INTEREST INCOME:			
Interest and fee income on loans	2,185	4,826	6,305
Income from lease financing			
Interest on balances with depository institutions			
Income on Federal funds sold and repos	66	350	512
Interest from assets held in trading accounts			
Interest and dividends on securities	268	406	512
Other Interest Income			
TOTAL INTEREST INCOME	2,519	5,582	7,329
INTEREST EXPENSE:			
Interest on deposits	858	2,434	3,832
Expense on Federal funds purchased and repos	5	18	18
Interest on demand notes, other borrowed money, mortgages, and capitalized leases.	31		
Interest on subordinated notes and debentures			
TOTAL INTEREST EXPENSE	894	2,452	3,850
NET INTEREST INCOME	1,625	3,130	3,479
NONINTEREST INCOME:			
Services charges on deposit accounts	234	461	415
All other noninterest income	70	128	228
TOTAL NONINTEREST INCOME	304	589	643
NONINTEREST EXPENSE:			
Salaries and employee benefits	750	1,422	1,342
Premises and fixed assets expense (net of rental income)	271	549	584
Amortization expense of intangible assets (including goodwill)			
Other noninterest expense	446	931	978
TOTAL NONINTEREST EXPENSE	1,467	2,902	2,904
Provision for loan and lease losses	300	1,025	1,580
Securities gains (losses)	15	48	
NET OPERATING INCOME (PRETAX)	177	(160)	(362)
Applicable income taxes	74	(36)	(117)
NET OPERATING INCOME (AFTERTAX)	103	(124)	(245)
Extraordinary credits (charges) net of income tax			
NET INCOME	103	(124)	(245)
Other increases in equity capital accounts	60		
Other decreases in equity capital accounts			
Cash dividends declared on common stock			
Net change in equity capital accounts for the period	163	(124)	(245)
Equity capital accounts at beginning of the period	6,027	6,151	6,396
Equity capital accounts at end of the period	6,190	6,027	6,151

Footnotes:

HOLDING COMPANY RATIOS AND TRENDS

CONSOLIDATED HOLDING COMPANY	HOLDING COMPANY (Date)	HOLDING COMPANY (Date)	HOLDING COMPANY (Date)
Net Operating Income to Average Assets			
Total Risk-Based Capital Ratio			
Leverage Capital Ratio			
This Institution's Assets to Consolidated Holding Company Assets			
PARENT ONLY			
Pre-Tax Operating Income and Interest Expense to Interest Expense (X) (Fixed Charge Coverage)			
Operating Income - Tax + Non-Cash Items to Total Operating Expense and Dividends Paid (Cash Flow Match)			
Total Liabilities to Equity			
Equity Investments in Subsidiaries to Equity (Double Leverage)			
Equity Investment in Subsidiaries - Equity Capital/Net Income - Dividends (Double Leverage Payback in Years)			

EXTENSIONS OF CREDIT TO AFFILIATED ORGANIZATIONS

DESCRIPTION	DIRECT	INDIRECT	TOTAL
A. Affiliated organizations including securities issued by affiliated organizations.	250		250
B. Indebtedness of others, or portions of such indebtedness, collateralized by securities issued by affiliated organizations.			0
Total	250	0	250
Less duplications within and between groups			0
Net Total	250	0	250

Comments:

HOLDING COMPANY

Any Company, Inc.
Anytown, Anystate

SUBSIDIARY

Any Time, Inc.
Anytown, Anystate

OTHER AFFILIATES

Any Body, Inc.
Anytown, Anystate

This page as shown above does not include all information that could be included to support examination findings, but is for illustrative purposes only. Refer to the instructions for this page for specifics.

Extensions of Credit to Directors/Trustees, Officers, Principal Shareholders, and Their Related Interests	99999

Description		Total
A. Executive Officers and their related interests		1,200
B. Directors/Trustees and Principal Shareholders and their related interests		250
TOTAL		1,450
Less duplications within and between groups		250
NET TOTAL		1,200
Capital and unimpaired surplus as of last Call Report date (Per Regulation “O”)		7,094
Net total insider borrowing as a percentage of unimpaired capital and surplus		16.92%
NAME AND COMMENTS (Designate all duplications with a “D”)	Detail	% of Unimpaired Capital & Surplus

GROUP A

LINCOLN, ALLIE C. Director and President	500	7.05%
GUTIERREZ, JOHN M. Executive Vice President and Cashier	450	6.34%
ANY BODY, INC. Duplication debt guaranteed by President Lincoln and Director Killingbird.	250 D	3.52%
TOTAL	1,200	

GROUP B

ANY BODY, INC. A related interest of President Lincoln and Director Killingbird. Both individuals guarantee the debt.	250 D	3.52%

Safety and Soundness

Composite 3. Financial institutions in this group exhibit some degree of supervisory concern in one or more of the component areas. These financial institutions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Financial institutions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a composite 1 or 2. Additionally, these financial institutions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. These financial institutions require more than normal supervision, which may include formal or informal enforcement actions. Failure appears unlikely, however, given the overall strength and financial capacity of these institutions.

Information Technology

Composite 2. Financial institutions and service providers rated composite "2" exhibit safe and sound performance but may demonstrate modest weaknesses in operating performance, monitoring, management processes, or system development. Generally, senior management corrects weaknesses in the normal course of business. Risk management processes adequately identify and monitor risk relative to the size, complexity, and risk profile of the entity. Strategic plans are defined but may require clarification, better coordination, or improved communication throughout the organization. As a result, management anticipates, but responds less quickly to changes in market, business, and technological needs of the entity. Management normally identifies weaknesses and takes appropriate corrective action. However, greater reliance is placed on audit and regulatory intervention to identify and resolve concerns. The financial condition of the service provider is acceptable and while internal control weaknesses may exist, there are no significant supervisory concerns. As a result, supervisory action is informal and limited.

Trust

Composite 2. Administration of fiduciary activities is fundamentally sound. Generally no component rating should be more severe than 3. Only moderate weaknesses are present and are well within management's capabilities and willingness to correct. Fiduciary activities are conducted in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, as a result, the supervisory response is informal and limited.

Compliance

Composite 2. An institution in this category is in a generally strong compliance position. Management is capable of administering an effective compliance program. Although a system of internal operating procedures and controls has been established to ensure compliance, violations have nonetheless occurred. These violations, however, involve technical aspects of the law or result from oversight on the part of operating personnel. Modification in the bank's compliance program and/or the establishment of additional review/audit procedures may eliminate many of the violations. Compliance training is satisfactory. There is no evidence of discriminatory acts or practices, reimbursable violations, or practices resulting in repeat violations.

Community Reinvestment Act (CRA)

A CRA rating of "**Satisfactory**" is assigned. An institution in this group has a satisfactory record of helping to meet the credit needs of its assessment area, including low- and moderate income neighborhoods, in a manner consistent with its resources and capabilities.

Refer to *http://www.fdic.gov/regulations/examinations/ratings/index.html* for definitions of all composite ratings.

Signatures of Directors/Trustees	99999

We the undersigned directors/trustees of Bank of Anytown, Anytown, Anystate, have personally reviewed the contents of the Report of Examination dated June 30, 2012.

Signatures of Directors/Trustees	**Date**
HENRY P. HERRINGTON	
MICHAEL D. JONES	
LARRY G. KILLINGBIRD	
KELLY A. KING	
ALLIE C. LINCOLN	
JOHN S. MARVEL	
JOHN D. PICKINGER	
SEAN RATZLAFF	

NOTE: This form should remain attached to the Report of Examination and be retained in the institution's file for review during subsequent examinations. The signatures of committee members will suffice only if the committee includes outside directors and a resolution has been passed by the full board delegating the review to such committee.

CONTROL AND RELATIONSHIPS

Any Company, Inc., a one-bank holding company, continues to own 100 percent of the bank's common stock. Bank directors own or control a combined 908,584 shares or 56 percent of holding company stock. President Lincoln is the largest individual stockholder, controlling 500,326 shares or 31 percent of the outstanding stock. Any Time, Inc. is a subsidiary of the bank and holds title to ORE. Any Body, Inc., is an on-premise insurance agency owned by President Lincoln and Director Killingbird. President Lincoln stated that no ownership or management changes are planned.

DIRECTOR INVOLVEMENT

Invitations for the bank's directors to participate in examination discussions were extended during the pre-exam and on-site portions of the examination. Outside director involvement was limited to the Board meeting.

EXAMINATION SCOPE

Examination Number 12345

The examination scope was expanded from the pre-exam planning (PEP) memo in the following areas:

- *Construction Lending* – Expanded due to administrative problems identified in the original loan sample. Ten additional construction loans serviced by the two construction lenders and originated in 2012 were reviewed.
- *Bank Secrecy Act Review* – Expanded to include a review of all Currency Transaction Reports filed in 2012 due to indications that they were being filed late.
- *Call Reports Review* – Expanded to include year-end 2011 in response to the volume of errors noted with our original review.

As a result, examination hours, totaling 760, are 150 over budget (25 percent). Other examination procedures were not modified from those identified in the PEP memo.

LOAN PENETRATION

Asset review date:	6/30/2012
Number of relationships reviewed:	55
Total $ of credit extensions reviewed / % of Total	$28,148M / 52%
Total $ of non-homogenous credit extensions reviewed / % of Total	$27,635M / 60%
Credit extension cutoff review point:	$450M

REMINDERS – The loan penetration comment can include a breakdown of credit extensions by major loan types, location, officer, etc., as appropriate.

INFORMATION TECHNOLOGY (IT) SCOPE

Examination Number 12348

The IT examination included a review of logical and physical security, electronic payments, IT-related audits, vendor management, and disaster recovery planning. The review also included an assessment of management's efforts to comply with Interagency Guidelines Establishing Standards for Safeguarding Customer Information (Guidelines) set forth in Part 364, Appendix B, of the FDIC Rules and Regulations. Findings of the IT review were discussed in detail on August 27, 2012, with Information Technology Manager William Robbins and President Lincoln.

TRUST EXAMINATION SCOPE
Examination Number 12346

The scope of the trust review included a review of policies, practices, and procedures, trust-related comments in Board minutes, the last external audit, selected accounts, compliance with applicable laws, and matters criticized at previous examinations. The account review included seven accounts.

Fiduciary activities pose limited risk to the institution. Total Trust Department assets are $3,318M held in 8 personal trust accounts, 44 burial trust accounts, and 1 farm management agency account. Department records are currently maintained manually, but Trust Officer Hancock is gradually migrating the accounts to a computerized system using Delta Data software running on a stand-alone computer.

A meeting was held on August 27, 2012, with President Lincoln and Trust Officer Hancock to discuss Trust examination findings in detail.

BANK SECRECY ACT (BSA) REVIEW SCOPE
Examination Number 12347

Examiners reviewed the bank's compliance with the BSA and financial recordkeeping regulations. Core analysis procedures of the Examination Documentation module were completed, as well as expanded procedures related to timely CTR filings, to summarize the findings of this review. Examiners compared bank records with information on the FinCEN CTR filing data report for October through December 2011, and year-to-date 2012. FinCEN 314(a) requests are being received and checked by management. BSA examination findings were discussed on August 27, 2012, with President Lincoln and BSA Officer Donna Ludlow.

OFFICE OF FOREIGN ASSETS CONTROL (OFAC) SCOPE

Examiners reviewed the bank's OFAC risk assessment, policies and procedures, independent testing of the bank's OFAC compliance program, blocked accounts, and correspondence received from OFAC. Examiners also conducted sample testing of the bank's OFAC compliance program.

SUGGESTIONS FOR FUTURE EXAMINATIONS

- There is sufficient working space for seven examiners.
- Management accommodated working hours of 7:30am to 5:30pm.
- The examination crew should contain at least one examiner with experience in construction loan analysis.
- ALERT data can only be provided in fixed-width format.

List alphabetically all directors/trustees, senior officers, and principal stockholders. Also indicate their titles. Number of shares owned is not rounded. (J – indicates stock jointly owned; P – indicates preferred stock owned; H – indicates holding company stock owned; C – indicates stock controlled but not owned)

Names and Comments	Net Worth		Year Joined Bank	Year of Birth	Atten-dance	Number of Shares Owned	Salary and Bonus (B)
	Amount	Date of Statement					

Biographical and background information on directors, officers, and other key management officials listed on this page should be prepared in accordance with the Report of Examination Instructions.

DIRECTORS/TRUSTEES

Names and Comments	Amount	Date of Statement	Year Joined Bank	Year of Birth	Attendance	Number of Shares Owned	Salary and Bonus (B)
HERRINGTON, HENRY P. Attorney *Address*	501	3/1/2011	1980	1961	12	50,992 (H)	
JONES, MICHAEL D. Commercial RE Consultant (1) *Address*	7,890	6/1/2011	1983	1959	5	5,005 (H)	
KILLINGBIRD, LARRY G. Automobile Dealership Owner (1) *Address*	10,000	(3)	1981	1955	12	200,150 (H)	
KING, KELLY A. Retired Doctor *Address*	2,500	6/1/2011	1979	1933	12	1,010 (H)	
LINCOLN, ALLIE C. President (1)(2) *Address*	1,357	2/1/2011	1982	1951	12	500,326 (H)	100 25(B)
MARVEL, JOHN S. Economist *Address*	3,565	3/1/2011	1981	1950	11	150,500 (H)	
PICKINGER, JOHN D. Certified Public Accountant (2) *Address*	7,234	8/7/2011	1982	1954	11	101 (H)	
RATZLAFF, SEAN Chairman of the Board (1)(2) *Address*	5,000	(4)	1980	1960	12	500 (H)	24(B)

Names and Comments	Net Worth		Year Joined Bank	Year of Birth	Atten-dance	Number of Shares Owned	Salary and Bonus (B)
	Amount	Date of Statement					
OFFICERS, NOT DIRECTORS/TRUSTEES							
COMMANDER, LESLIE S. Executive Vice President - Commercial Lending (1)			1983	1960			85
GUTIERREZ, JOHN M. Executive Vice President / Cashier (2)			1983	1958			70
PRINCIPAL SHAREHOLDERS, NOT DIRECTORS/TRUSTEES OR OFFICERS							
ANY COMPANY, INC. Anytown, Anystate						162,247	

(1) Loan Committee
(2) Investment Committee
(3) Estimated by President Lincoln
(4) Estimated by *Money Magazine*

Total Holding Company shares owned by the Directorate: 908,584
Percentage Holding Company ownership by the Directorate: 56 percent

There have been 12 regular Board meetings since the last regulatory examination.
Director fees are $250 per Board meeting attended.
Committee fees are $100 per committee attended.

INTERNATIONAL

REPORT PAGES

AND WORKPAPERS

		CATEGORY			
AMOUNT, DESCRIPTION, AND COMMENTS	**Exposures Warranting Special Comment**	**Other Transfer Risk Problems**	**Substandard**	**Value Impaired**	**Loss**
Argentina					
October 21, 2010					
All Other Exposures (including Bank Credits)				181	
Less: Credit Risk Adverse Classification				(181)	
Net Exposure				0	

In December 2009, the Argentine government defaulted on $50 billion of bonds held by foreign creditors and subsequently imposed strict capital controls that have severely limited the ability of private borrowers to service their external liabilities. Private Argentine borrowers have accumulated significant interest and principal arrears to external creditors. Prior to the present interruption of external debt service, the country had been current on payments since completing a Brady-plan restructuring of bank debt in the early 1990s. A Paris Club rescheduling in 1992 accompanied that exercise.

U.S. banks cut their exposures to Argentina sharply in 2010, reflecting both large reductions in business activity and credit lines, and significant write-offs. In June 2010, U.S. banks' cross-border exposure totaled $6.2 billion, down roughly 44 percent from a year earlier. Locally funded business fell by over two-thirds, to $3.3 billion.

A severe and extended …

Performing short-term trade credits …

Amount scheduled represents restructured trade exposure with Banco CMF, scheduled as Value Impaired (net of reserve). Amount is not extended for transfer risk as it is subject to a credit risk Doubtful classification.

Note that this write-up is incomplete. Refer to specific guidance for this page in the Report of Examination Instructions Section of the Manual.

DISCLAIMER: This page is provided for illustrative purposes only. It is not intended to correspond with or tie to information in the Bank of Anytown Report of Examination.

Management of the country risk process is regarded as generally satisfactory. Senior management and the Asset/Liability Management Committee continue to closely monitor the economic and political stability of countries where the bank maintains international transaction activity. Due to deteriorated economic and political situations in certain of the countries where the bank conducts business, there has been a reorientation of business strategy. The Board has strategically decided to focus future business development on its domestic banking market and to basically reduce its overall risk emanating from transfer risk exposure. As a result, the bank has substantially reduced the level of approved country limits, and it has “frozen” most assigned limits, and the resulting level of net transfer risk exposure. Also, the Board has reduced …

The current examination revealed five concentrations of transfer risk …

The International Policy is adequate; however, the following deficiencies …

Note that this write-up is incomplete. Refer to specific guidance for this page in the Report of Examination Instructions Section of the Manual.

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CROSS BORDER/CROSS CURRENCY CLAIMS AND CONTINGENT CLAIMS				ADJUSTMENT FOR GUARANTEES				
Amount Maturing in								
Less than 1 year	More than 1 year	Commitments / Contingent Claims	Subtotal by location of borrowers	Plus other credits guara--nteed by residents in this country	Less credits externally guaranteed	Net local current assets of offices in this country	Exposure by Country of risk	Exposure by Country of risk as a % of Tier 1 capital
ARGENTINA								
981					800		181	1.00%
BRAZIL								
2,000							2,000	11.00%
DOMINICAN REPUBLIC								
1,000							1,000	6.00%
ECUADOR								
1,233					1,209		24	0.14%
GUATEMALA								
5,358					1,698		3,660	21.00%

Note: Adjustments for external guarantee represent available cash and/or ATRR. All dollar amounts are reported in thousands.

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International Loans, Acceptances, and Letters of Credit - Distribution	99999

An international loan, acceptance, or letter of credit is defined as any such instrument between this bank and a resident or entity domiciled outside the United States, District of Columbia, Puerto Rico or other United States Territory or Possession.

DISTRIBUTION

Description	**Amount**
Mortgage loans (Including Ship loans of $_2,327_______)	8,732
Loans insured or guaranteed by the U.S. government or its agencies	14,065
Loans to foreign governments, agencies thereof and central banks	15.971
Loans to financial institutions other than central banks	500
Loans to commercial, industrial and agricultural interests	41,689
Other Loans (Describe) Loans to religious institutions	8,572
All other loans	1,171
Total International Loans*	90,700
*Does NOT include loans to U.S. subsidiaries of foreign corporations	12,444

Description	**Amount**
Participation loans and paper purchased	41,505
Placed paper, direct loans and participation loans sold	5,365
Syndication and consortium financing	5,000
International acceptances outstanding	1,489
International letters of credit outstanding	7,836
Other (Describe)	

1. Are duties and responsibilities for the conduct of international operations clearly defined? Comment briefly.

Yes. The bank's Board of Directors has a written policy statement setting forth the various duties and responsibilities of the operating entities within the international division.

2. Does the bank have a definite international lending policy? If "yes", summarize such, state whether it has been approved by the board of directors/trustees, and indicate extent of compliance.

Yes. The subject bank's Board of Directors, in line with the directives of the parent bank, has delineated specific guidelines on clientele to be served, limits on country exposure both in the aggregate and by maturity within those limits and risks to be undertaken. Officers submit recommendations to the international loan committee which has authority to approve loans up to $5 million. Larger loans require senior loan committee approval. In all cases, these policies have been followed.

3. (a) Comment upon policy guidelines in effect regarding country risk assets and volume limitations imposed thereon. (b) How often are guidelines reviewed? (c) Does the bank have any country risk concentrations of credit? If "yes", list the country and percentage of such extensions of credit to the bank's total capital and reserves.

(a) Policy calls for all extensions of credit including bank placements, formal loan commitments, and foreign exchange lines to be included within country limits. Claims are reallocated to the country of guarantor or the country where collateral is realizable. Sub-limits are provided by maturity of the obligation. Separate limits are provided for in each of the 15 countries where lending is permitted.

(b) Reviewed quarterly.

(c) Yes, Japan 84%, France 40%, Federal Republic of Germany 59%, United Kingdom 39%.

4. Are guarantees of other banking institutions and/or parent or affiliated organizations of borrowers required on certain loan obligations? If "yes", under what circumstances and in what form are such guarantees extended?

Yes. Letters of Guarantee from two European banks have been furnished as support to financially weak borrowers. The parent bank has extended guarantees in the form of letters of credit essentially to provide additional protection to the subject bank's position. The parent's guarantee was not relied upon as a primary source for repayment of the loan.

5. (a) Describe the general nature and character of collateral pledged, and (b) comment upon the adequacy of supporting documentation.

(a) Collateral includes first preferred ship mortgages, notes and bond obligations of various foreign governments, time deposits, commodities, stocks, and UCC filings.

(b) Supporting documentation appeared in order.

6. Is credit information timely in content and available in sufficient readable detail?

Credit information on loans originated at the Nassau Branch continues to be inadequate. Deficiencies include a lack of current and complete financial information on the obligor and guarantor, an absence of thorough credit analysis, and a lack of complete information on country conditions.

7. (a) Describe the general nature and types of acceptance financing extended, and (b) the general lines of business involved.

(a) Bank is primarily involved in acceptance financing in connection with international trade activity; several million dollars in dollar exchange acceptances were booked between examinations.

(b) Manufactured goods, commodities, and exchange activities of central banks.

8. (a) Describe the general nature and types of letter of credit accommodations offered, and (b) the general lines of business involved.

(a) The bank issues documentary letters of credit to importers, confirms other banks' letters of credit for export customers and, to a limited extent, engages in deferred payment letter of credit financing. Standby letters of credit are undertaken only for prime customers.

(b) Manufacturers, machinery exporters and importers, commodity importers, and foreign governments and agencies.

9. Describe the provision for repayment of (a) acceptances, and (b) drafts drawn under letters of credit. Include comment regarding extent of refinancing.

(a&b) Provisions for repayment are arranged prior to issuance and vary as individual conditions warrant. Repayment is generally accomplished by charge to customer's account or by loan accommodation under approved credit lines in the case of acceptances and by charge to the customer's account or acceptance with respect to letters of credit. In certain situations, refinancing is permitted, generally for short periods.

1. Comment on the general nature and volume of present eurocurrency operations.

Eurocurrency operations are conducted through the Nassau Branch. Investments are primarily loans to South American corporations and central governments, securities of foreign governments and bank placements. Sources of funding are IPC, bank and affiliate time deposits. At examination date, Eurocurrency loans, securities, and bank placements totaled $325 million with $285 million funded by Eurocurrency time deposits and the remainder through main office funds.

2. Describe the procedures followed and guidelines utilized in establishing lines of credit and making and approving due to (takings) and due from (placements). Comment on the adequacy of procedures enabling senior management to ascertain compliance with guidelines and directives.

The parent bank has issued general guidelines to be considered before establishing lines of credit and bank relationships. With respect to banks, these criteria center on the obligor's capital resources, country risk, and type of institution. Bank and nonbank clientele analysis includes consideration of volume and maturity factors, as well as a review of financial responsibility and reputation. Senior management receives weekly reports.

3. (a) Comment on the maturity composition of present eurocurrency takings and placements and the effect of such on the bank's liquidity position. (b) Are asset and liability maturities reasonably matched?

(a) At examination date, Eurocurrency takings totaled $285 million, while placements aggregate $195 million. All placements and 74% of takings ($210 million) mature within 90 days with no adverse effects on the bank's liquidity position.

(b) Both near-term and longer-term maturities are reasonably matched.

4. Are all interbank placements confirmed at inception and, thereafter, subject to periodic direct verification audits?

Yes.

NOTE: A negative answer below (questions 2 through 8(e)) may be indicative of a condition in need of correction. Such answers may call for comment, or expanded treatment, below or elsewhere in the examination report.

DESCRIPTION	YES	NO
1. Is the bank engaged, in any manner, in foreign exchange activities? If "Yes", answer the following questions:	X	
2. Is the net open position of each foreign currency reasonable in relation to the bank's total capital and reserves?	X	
3. Is the aggregate net open position of all foreign currencies reasonable in relation to the bank's total capital and reserves?	X	
4. Are the future maturities of foreign currency assets, liabilities, and contracts reasonably matched with respect to long and short positions in all time periods?	X	
5. Does a current revaluation of the bank's foreign currencies reflect an insignificant profit or loss?	X	
6. Has the directorate and/or head office imposed reasonable guidelines and limits with respect to foreign exchange operations?	X	
7. Are guidelines and limits being adhered to by active management?	X	
8. With respect to foreign exchange operations, are the following adequate:		
(a) recording procedures?	X	
(b) bookkeeping procedures other than 8(a)?		X
(c) contract confirmation procedures?	X	
(d) internal routines and controls other than 8(c)?	X	
(e) audit procedures?	X	

8(b) Refer to comments under Audit and Internal Controls.

Position Analysis - Major Currency Positions	**99999**

Country United Kingdom	**Monetary Unit Pound Sterling**			
Description	**Assets and Purchases (Long Position)**		**Liabilities and Sales (Short Position)**	
	Foreign Currency	U.S. Dollar Book Value	Foreign Currency	U.S. Dollar Book Value
Cash	1,000	2,600		
Demand Balances Due (Nostro)	50,000	19,800		
Loans	1,000,000	2,500,000		
Securities	100,000	275,800		
Deposits of Banks (Vostro)			100,000	242,000
Other Deposits			400,000	1,040,000
Spot Contracts	1,300,000	3,120,000	1,400,000	3,346,000
Forward Contracts				
Holdovers				
Other: (Specify) Accrued Interest Receivable	10,500	25,200		
Accrued Interest Payable			3,000	7,200
Gross Position	2,461,500	5,943,400	1,903,000	4,635,200
Less: Long/Short	1,903,000	4,635,200		
Net Position	558,500	1,308,200		
Net position as a % of the bank's total capital and reserves:	2.90%			

		OTHER CURRENCIES						
		Long		**Short**		**Net Position**		**(%)***
Country	**Monetary Unit**	Foreign Currency	U.S. Dollar Book Value	Foreign Currency	U.S. Dollar Book Value	Foreign Currency	U.S. Dollar Book Value	**Net Position**
Australia	Dollar	24,600	27,900			24,600	27,900	0.06%
Canada	Dollar	66,000			90,000	66,000	(90,000)	0.20%
France	Franc	1,000,000	210,000			1,000,000	210,000	0.47%
Germany	Mark	693,000	215,000	203,000	61,000	490,000	154,000	0.34%
Italy	Lire	27,873,600	30,500	54,344,500	59,500	(26,470,900)	(29,000)	0.06%
Switzerland	France					0	0	0.00%
						0	0	0.00%
						0	0	0.00%
						0	0	0.00%
						0	0	0.00%
						0	0	0.00%
						0	0	0.00%
						0	0	0.00%
						0	0	0.00%
						0	0	0.00%
						0	0	0.00%
Subtotal (U.S.)						0	536,200	0.00%
Plus: Major Currency (U.S.)							1,308,200	
Aggregate Position (U.S.)						0	0	
* as a percentage of the bank's Total Capital and Reserves.							1,844,400	3.88%

DESCRIPTION	YES	NO
1a. Is the net open position of each foreign currency reasonable in relation to the bank's total capital and reserves?	X	
1b. Is the aggregate net open position of all foreign currencies reasonable in relation to the bank's total capital and reserves?	X	

MATURITY DISTRIBUTION SCHEDULE

Monetary Unit	Maturity Dates	Assets and Purchases Long	Liabilities and Sales Short	Net Gap for Period Long/Short	Spot Rate P = Prem. D = Disc.	Profit	Loss
		F.C.	F.C.	F.C.		U.S.	U.S.
Pound (UK)	5/15	51,000	100,000	(49,000)			
	5/16	25,000		25,000			
	5/17	25,000		25,000			
	5/18	35,000		35,000			
	5/19	50,000	40,000	10,000			
	5/22		50,000	(50,000)			
	5/23	50,000	75,000	(25,000)			
	5/24	100,000	50,000	50,000			
	5/25	50,000		50,000			
	5/30	50,000	75,000	(25,000)			
	5/31		100,000	(100,000)			
	June	110,500	100,000	10,500			
	July	125,000	203,000	(78,000)			
	August	175,000	110,000	65,000			
	September		75,000	(75,000)			
	October	245,000	225,000	20,000			
	November	175,000	100,000	75,000			
	December	325,000	200,000	125,000			
	20X6	370,000	300,000	70,000			
	20X7	150,000	50,000	100,000			
	20X8	250,000	50,000	200,000			
	After	100,000		100,000			
	TOTALS	2,461,500	1,903,000	558,500		0	0
				Less:	Profit/Loss		
				Future	**Adjustment**	0	0
						YES	**NO**

2. Are future maturities of foreign assets, liabilities, and contracts reasonably matched with respect to long and short positions in all time periods?	X	

Revaluation and Income/Loss Analysis	99999

Monetary Unit	Book Value of Net Position F.C.	U.S.	Exam Date Spot Rate	Current U.S. Market Value (F.C. x Spot)	U.S. Spot Rate Profit (Loss)	U.S. Future Profit (Loss) Adjustment	U.S. Net Profit or (Loss)
Australia $	24,600	27,900	1.149500	28,300	400		400
				0	0		0
Canada $	66,000	(90,000)	0.868300	57,300	147,300	(500)	146,800
				0	0		0
France Franc	1,000,000	210,000	0.219100	219,100	9,100		9,100
				0	0		0
German Mark	490,000	154,000	0.493800	242,000	87,700		87,700
				0	0		0
Italian Lira	(26,470,900)	(29,000)	0.001176	(31,100)	(2,100)		(2,100)
				0	0		0
Swiss Franc	(60,700)	(25,300)	0.532800	(32,300)	(7,000)		(7,000)
				0	0		0
UK Pound	558,500	1,308,200	2.222000	1,241,000	(67,200)	1,000	(66,200)
				0	0		0
				0	0		0
				0	0		0
				Total	168,200	500	168,700

Does not include $ profit (loss) attributable to outstanding SWAP transactions

$ has already been taken into income/expense through accrual accounting

	YES	NO
3. Does a current revaluation of the bank's foreign currencies reflect an insignificant profit or loss?	X	

Previous Calendar Year	Amount or Percent
Quarterly Average of Gross Assets	562,500,000
Total Foreign Exchange Income	1,000,000
Net Foreign Exchange Income (Loss)	550,000
% of Total Foreign Exchange Income to Average Gross Assets	0.18%
% of Net Foreign Exchange Income (Loss) to Average Gross Assets	0.10%
Year to Date	**Amount or Percent**
Total Operating Income (Bank)	25,156,300
Net Operating Income (Loss)	4,192,700
Total Foreign Exchange Income	735,200
Net Foreign Exchange Income (Loss)	404,400

1. **(a) Describe the net and aggregate position limits, maturity exposure limits, and any other limits placed on foreign exchange operations by the board of directors/trustees. (b) Do such limits appear reasonable?**

   (a) The bank's Board of Directors has authorized trading only in these currencies listed in the position schedules. Overnight limits for each currency with the exception of the pound sterling are fixed at $250M; pound sterling limit is $1,500M. The aggregate position limit for all currencies is $2,000M. Maturity gaps are authorized only on major active currencies up to $100M not to exceed 3 months. Major active currencies have been described as having an active forward market. No general ledger account limits have been formulated.

   (b) Limits appear to be reasonable.

2. **Describe the limits and guidelines established by the board of directors/trustees for dealing in foreign exchange with other banks and customers.**

   Individual customer limits are approved by the bank's International Committee based on the customer's creditworthiness and the volume of its foreign currency needs. The bank's written internal credit policy pertaining to bank and nonbank customer foreign exchange lines is:

   (a) 100% of foreign exchange line may mature within 180 days;
   (b) 50% of the foreign exchange line may mature within 360 days;
   (c) 20% of the foreign exchange line is available for contracts with maturities up to 18 months;
   (d) no maturities may exceed 18 months.

   Excesses must be approved in writing by the account officer who approved the customer line. Maximum daily delivery risk limits per customer are set at 20% of the aggregate limits approved.

3. **Fully describe any recent significant deviations by the bank from established limits and guidelines. Include in this description any significant deviations noted after completion of the Position Analysis, and the Maturity Distribution (GAP) Analysis.**

   No deviations from bank policy were noted in preparing the position analysis. Two exceptions to bank policy on GAP exposure were in evidence due to an inability to obtain forward cover. These exceptions were approved by the International Committee. No other recent deviations from policy were uncovered.

4. **(a) Describe the reports (i.e., position maturity, gap, revaluation, etc.) required by the directorate and senior management to ascertain compliance with directives. (b) Is the directorate or senior management notified when actions are taken which constitute deviation from policy? If "Yes", describe the approval procedures for such deviations from policy.**

   (a) Net position reports enumerating all foreign currency balance sheet items, future contracts, and after-hour and holdover transactions are transmitted to the designee of the International Committee on a daily basis. Reports are prepared by the foreign exchange bookkeeping department and reconciled to the trader's blotter. Maturity gap reports are produced daily with the next month's transaction reflected on a daily basis and subsequent transactions grouped in two-week intervals. Revaluation reports detailing ledger accounts, spot contracts, and forward contracts are developed on a weekly basis.

(b) Bank's written policy provides for the immediate generation of exception reports where applicable limits are exceeded. Prior written approval of account officer is required for deviation from customer limits. Deviation from other limits is not permitted under any circumstances without prior approval of International Committee.

5. If the bank is a subsidiary of a foreign bank, (a) what controls and guidelines has the parent imposed on the bank's foreign exchange activities? (b) Describe the foreign exchange reports prepared by the bank for the parent.

(a&b) The aforementioned guidelines and limits have been implemented at the direction of the parent bank. All reports of the bank's audit department and the reporting mechanisms described in 4(a) are furnished to the parent bank for review.

6. How frequently and by whom is the foreign exchange position revalued? Briefly describe the procedures used in the revaluation. If forward contracts are not revalued at future rates, so indicate.

Revaluation is performed on a bi-weekly basis by the International Operations section. Actual realized profit or loss is calculated by applying current spot rates to balance sheet accounts, as well as contracts of very near maturities. Unrealized profit or loss on future transactions is determined by utilizing the appropriate forward rates to the net position for each future period in the bank's gap report.

7. Describe the general ledger accounts affected by the periodic revaluation and the journal entries used to effect changes in these accounts. If any accounts are being used to capitalize losses or defer immediate recognition of profit, so indicate.

Actual realized profit or loss is charged to the profit and loss account with offsetting entries to the applicable local currency ledger accounts. With respect to future transactions, the bank charges "estimated profit(loss) on foreign exchange futures" account for the amount of the adjustment with an offset to the profit and loss account. Profits and losses are recognized at the date of revaluation.

8. (a) Approximately what volume of the bank's foreign exchange dealings are with related companies or banks? (b) In what manner, if any, do the terms and conditions of such dealings vary from similar transactions with non-related companies and banks?

(a) During 2011, the bank entered into approximately $40,000M of forward contracts to purchase and sell foreign exchange with a related bank, First European Bank, London, England.

(b) Terms and conditions of contracts are substantially the same as transactions with non-related parties.

9. Regarding holdover and/or after hour transactions, (a) describe the bank's system for controlling and recording such transactions and (b) indicate how management is informed of such transactions before recordation. (c) Does the system appear to be correctly designed and adequately controlled?

(a-b-c) The foreign exchange control group prepares a list of holdover items. Holdover items are incorporated into the daily position sheet, which together with the holdover list, is furnished to management on a daily basis. Holdover items are posted as of the dates contracted. The system is considered adequately controlled.

NOTE: A negative answer below indicates a condition which may be in need of correction. Such answers may call for comment below and elsewhere in the regular examination report.

AUDIT

			YES	NO
1.		Have the directors/trustees made provision for an audit of the foreign exchange area?	X	
		If "Yes," indicate method utilized:		
	X	Employment of full time auditor.		
	X	Periodic employment of independent auditor.		
		Designation of an audit supervisor and an established program of internal audit by bank personnel.		
		Name of Audit Supervisor:		
2.		If the answer to question 1 is "yes", does the audit program include the following:		
	(a)	Periodic proof of forward and spot contracts?	X	
	(b)	Periodic proof and/or reconcilement of foreign exchange general ledger accounts?	X	
	(c)	Periodic direct verification of forward and spot contracts? Frequency: Annually Amount: $25,200,000	X	
	(d)	Review of management reports and adherence to guidelines?	X	
	(e)	Comparison of rate quotations in management reports and revaluations with outside sources?	X	
	(f)	Perusal of authorized signatures?	X	
	(g)	Briefly describe any other audit procedures conducted:		
3.		If applicable, has the bank corrected major criticisms noted in the last independent audit report? Date of audit: 12/31/2011		X
		Briefly describe major criticisms and/or recommendations in such report: The bank was criticized for not maintaining a complete and current set of instructional memoranda describing the information generated from the accounting system and the general and subsidiary ledger accounts affected by trading activity. This defect has been corrected. Deficiencies still exist with respect to confirmation procedures.		
4.		Is the foreign exchange audit program adequate as to scope and frequency?	X	
5.		Does the foreign exchange auditor or audit supervisor report regularly and directly to the bank's board of directors/trustees or a committee thereof?	X	
6.		Is a written audit report of the foreign exchange area maintained by the bank?	X	

2(c) All outstanding spot and forward contracts as of the audit date are directly verified.

NOTE: A negative answer below indicates a condition which may be in need of correction. Such answers may call for comment below and elsewhere in the regular examination report.

	INTERNAL CONTROLS	YES	NO
7.	Are all contracts recorded on the date contracted?	X	
8.	Is it a firm rule that all forward and spot contracts be confirmed at inception?	X	
9.	Has the bank instituted an effective and current (within seven days) follow-up system regarding unconfirmed and/or incorrectly confirmed forward and spot contracts?		X
10.	Are foreign exchange contracts and dealing slips prenumbered and used in such order?	X	
11.	Does the bank have an effective system of controls over the trader and the trading environment?	X	
	A "Yes" answer to this question will necessarily require a "Yes" answer to each of the following (as a minimum). Is it a firm rule that:		
	(a) The trader not be allowed to receive confirmations on forward and spot contracts?	X	
	(b) The trader not be allowed to sign contracts?	X	
	(c) The trader be prohibited from initiating and receiving interbank funds transfers, opening current accounts, or receiving credits to current accounts?	X	
	(d) The trader not be involved in the revaluation procedure?	X	
	(e) Trading activities be segregated from other bank activities, in particular the accounting, confirmation, and report functions?	X	

8-9 Although the bank has a firm rule regarding the confirmation of spot and future contracts, it was observed that outgoing confirmations are frequently incomplete, with dates of trade and value dates frequently omitted. Further, the confirmation exception log is haphazardly prepared and is not reviewed by an operations officer. These deficiencies were noted by both the bank's internal and external auditors; however, correction is yet to be effected. It is recommended that these areas of potential exposure be remedied at an early date.

DISCLAIMER: This information is provided for illustrative purposes of a complex PBO. It does not correspond to the ownership/control information provided in the Bank of Anytown.

List the following information for the bank(s) and/or bank holding company(s) in the PBO.

U.S. Name: Demo International Bank[1]
City, Country: Miami, FL
Number of Outstanding Shares: 1,000,000

Foreign Name: Demo International, C.A.
City, Country: Caracas, Venezuela
Number of Outstanding Shares: 50,000

Foreign Name: Demo Bank Venezuela[2]
City, Country: Caracas, Venezuela

Foreign Name: Demo Bank Brazil[3]
City, Country: Rio de Janeiro, Brazil

Foreign Name: Demo Bank Mexico
City, Country: Mexico City, Mexico
Number of Outstanding Shares: 100,000

[1] Of the ten entities that comprise the PBO, only the three foreign banks and the foreign bank holding company that actively engage in transactions with Demo International Bank, Miami, Florida are detailed above. The remaining five entities within the PBO structure include: JMM Holdings, Caracas, Venezuela which wholly-owns Demo Bank International, Panama City, Panama; Mendosa Finance Company, Caracas, Venezuela which wholly-owns Demo Bank International, Cartegena, Colombia and Demo Bank International, Bogota, Colombia.

[2] Wholly-Owned subsidiary of Demo International, C.A., Caracus, Venezuela.

[3] Wholly-Owned subsidiary of Demo Bank Venezuela, Caracas, Venezuela.

Detail the stock owned by the beneficial owner(s) whose direct/indirect control forms the nexus of the PBO.

U.S. Name: Demo International Bank	**Number of Shares**	**Percent Owned**	**Type of Control**
Beneficial Owner: Mendosa Family Trust (Jose Mendosa controls 100%)	750,000	75.00%	Direct
Beneficial Owner: Rivera Family Trust (Juan Rivera controls 100%)	250,000	25.00%	Direct

Foreign Name: Demo International, C.A.	**Number of Shares**	**Percent Owned**	**Type of Control[1]**
Beneficial Owner: Jose M. Mendosa	5,000	10.00%	Direct
Beneficial Owner: Carlita S. Mendosa	12,500	25.00%	Direct
Beneficial Owner: Paco M. Mendosa	7,500	15.00%	Direct
Beneficial Owner: Juan H. Rivera	12,500	25.00%	Direct
Beneficial Owner: Mendosa Family Members	12,500	25.00%	Direct

[1] Mr. Jose M. Mendosa has indirect control of the shares owned by his wife, Ms. Carlita S. Mendosa.

Foreign Name: Demo Bank Mexico	**Number of Shares**	**Percent Owned**	**Type of Control[1]**
Beneficial Owner: Jose M. Mendosa	50,000	50.00%	Direct
Beneficial Owner: Carlita S. Mendosa	25,000	25.00%	Direct

[1] Mr. Jose M. Mendosa has indirect control of the shares owned by his wife, Ms. Carlita S. Mendosa.

Discuss the factor(s) or combination of the attributes (besides or in addition to common stock ownership) that was considered in determining that sufficient control is exercised to conclude that a PBO relationship exists, including whether the individual, family or group of persons acting in concert:

1) Constitutes a quorum or a significant presence on the Board of Directors of both the U.S. depository institution and the foreign bank or the foreign bank holding company.

The members of the Mendosa family listed above serve as the chairman, vice chairman or director for the five foreign entities except that none of them are on the Board of Demo Bank Guatemala. Their membership does not constitute a quorum on any of the three foreign or the U.S. banks' Board, but does constitute a quorum on the Board of the foreign bank holding company, Demo International, C.A.

2) Controls, in any manner, the election of a majority of the directors of the U.S. depository institution and the foreign bank or the foreign bank holding company.

The minutes of the shareholder meeting for the election of the directorate for Demo Bank Venezuela were not available for review. However, it is believed that Mr. Jose Mendosa and his family members controlled the election through their ability to vote a majority of the holding company's stock. Mr. Jose Mendosa's ability to vote the majority of Demo International Bank's stock indicates that he controlled the election of its directorate.

3) Constitutes a quorum or a significant portion of the executive management of both the U.S. depository institution and the foreign bank or the foreign bank holding company.

The members of the Mendosa family listed above serve as the president, vice president or cashier of Demo International Bank, Demo International, C.A. and at the four foreign banks except Demo Bank Guatemala. Their positions constitute a quorum of the executive management at Demo International, C.A., but not at the three foreign banks or at the U.S. bank. However, they occupy critical positions on those teams.

4) Exercises a controlling influence over the management and/or policies of both organizations.

Mr. Jose Mendosa's position as chairman of Demo International Bank and as president of Demo Bank Venezuela enables him to exert a controlling influence over the management and policies of both organizations.

5) Engages in an unusually high level of reciprocal correspondent banking and/or other transactions or facilities between the U.S. depository institution and the foreign bank.

The institutions primarily engage in correspondent bank services, dollar clearings, letters of credit, and trade related transactions. Fee income from transactions with the three foreign banks accounts for slightly over 40 percent of the total fee income generated by Demo International Bank, Miami, Florida in 2011. The U.S. bank also extended a $5 million line of credit secured by a $5 million certificate of deposit to Demo Bank Venezuela, Caracus, Venezuela.

6) Obtains financing to purchase the stock of either the U.S. depository institution or the foreign bank or the foreign bank holding company from, or arranged by, the foreign bank, especially if the shares of the U.S. depository institution are collateral for the stock-purchase loan.

None noted.

7) Requires the U.S. depository institution to adopt particular/unique policies or strategies similar to those of the foreign bank, such as common or joint marketing strategies, cross-selling of products, sharing of customer information, or linked web sites.

The Demo International Bank's web site is linked to Demo Bank Venezuela's web site. Both offer similar loan and deposit products and banking services.

8) Names the U.S. depository institution in a similar fashion to that of the foreign bank.

The titles of the banking organizations use similar naming conventions.

9) Presents any other factor(s) or attribute(s) that impacted the conclusion.

None known.

Summarize the Examination's Findings, including any concerns and criticisms relative to the PBO.

The review determined that a PBO relationship exists between Demo International Bank and three foreign banks and a foreign bank holding company through the common control of the Mendosa family, primarily through Mr. Jose Mendosa's ownership/control of the Demo International Bank in Miami, Florida, Demo International, C.A. (foreign bank holding company), and Demo Bank Mexico in Mexico City, Mexico.

Bank management acknowledges that the institutions are under common control. Management actively monitors all transactions with affiliated entities. No adverse trends were noted except that management was encouraged to devote additional time to review the banks' heightened wire activity. Refer to the Related Organizations page and the Risk Management Assessment page for additional information.

If a PBO relationship exists, then the field supervisor or case manager should forward this document under a cover letter to the Associate Director of the International and Large Bank Branch.