

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

OKLAHOMA STATE BANKING DEPARTMENT
OKLAHOMA CITY, OKLAHOMA

Written Agreement by and among)
LEGACY BANK) Docket No. 03-004-WA/RB-SM
Hinton, Oklahoma)
FEDERAL RESERVE BANK)
OF KANSAS CITY)
Kansas City, Missouri)
and)
OKLAHOMA STATE)
BANKING DEPARTMENT)
Oklahoma City, Oklahoma)
_____)

WHEREAS, in recognition of their common goal to restore and maintain the financial soundness the Legacy Bank (the "Bank"), Hinton, Oklahoma, a state chartered bank that is a member of the Federal Reserve System and is owned and controlled by Midstate Bancorp, Inc., Hinton, Oklahoma ("Midstate"), a registered bank holding company, the Bank, the Federal Reserve Bank of Kansas City (the "Reserve Bank"), and the Oklahoma State Banking Department (the "Banking Department") have mutually agreed to enter into this Written Agreement (the "Agreement"); and

WHEREAS, on Feb 18, 2003, the board of directors, at a duly constituted meeting, adopted resolutions authorizing and directing Samuel Garmyck to enter into this

Agreement on behalf of the Bank, and consenting to compliance by the Bank and its institution-affiliated parties, as defined in section 3(u) of the Federal Deposit Insurance Act, as amended (the "FDI Act") (12 U.S.C. 1813(u)), with each and every provision of this Agreement.

NOW, THEREFORE, the Bank, the Reserve Bank, and the Banking Department agree as follows:

Management Review

1. (a) Within 10 days of this Agreement, the board of directors shall retain an independent consultant acceptable to the Reserve Bank and the Banking Department to conduct a review of the composition and structure of the Bank's management and board of directors (the "Review"), and to prepare a written report of findings and recommendations (the "Consultant's Report"). The primary purpose of the Review shall be to aid in the development of a board and management structure suitable to the needs of the Bank that is adequately staffed by qualified and trained personnel. The terms of the contract with the consultant shall require that the Review be completed and the Consultant's Report submitted to the board of directors within 60 days of retention of the independent consultant. The Review shall, at a minimum, address, consider, and include:

- (i) The identification of the type and number of officer positions needed to manage and properly supervise the Bank's affairs;
- (ii) the effectiveness of the board of directors in properly supervising the management and affairs of the Bank;
- (iii) the need for independent directors who are not officers of the Bank or related to officers of the Bank by blood or marriage;
- (iv) the identification and establishment of board of directors committees that are needed to provide guidance and oversight to Bank management;
- (v) an evaluation of each senior Bank officer to determine whether the individual possesses the ability, experience, and other qualifications required to competently perform present and anticipated duties, to adhere to the Bank's established policies and

- procedures, to restore and maintain the Bank to a safe and sound condition, and to comply with the requirements of this Agreement;
- (vi) an assessment of whether Bank officers are compensated commensurate with their duties and their abilities to perform those duties competently; and
 - (vii) a plan to recruit, hire, or appoint additional or replacement personnel with the requisite ability, experience, and other qualifications required to competently perform their assigned duties.

(b) Within 45 days of receipt of the Consultant's Report, the Bank shall submit to the Reserve Bank and the Banking Department a written management plan that fully addresses the findings and recommendations of the Consultant's Report and describes the specific actions that the board of directors proposes to take in order to strengthen the Bank's management.

(c) In appointing any new officers or directors, the Bank shall comply with the notice provisions of section 32 of the FDI Act (12 U.S.C. 1831i) and Subpart H of Regulation Y of the Board of Governors.

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

Board Oversight

2. Within 60 days of receipt of the Consultant's Report, the board of directors shall submit to the Reserve Bank and the Banking Department a written plan to strengthen board oversight of the Bank's management and operations. The plan shall, at a minimum, address, consider, and include:

(a) The actions that the board of directors will take to improve the Bank's condition and maintain effective control over and supervision of the Bank's senior management, major operations, and activities, including, at a minimum:

- (i) an independent and effective audit function;
- (ii) internal control systems and recordkeeping procedures;
- (iii) a loan review system;
- (iv) training programs for the boards of directors, management, and staff; and
- (v) compliance programs;

(b) the responsibility of the board of directors to monitor management's adherence to approved plans, policies, procedures, programs, and applicable laws and regulations;

(c) a description of the detailed information to be included in the periodic reports that will be reviewed by the board of directors in its oversight of the Bank's operations and management, including information sufficient to assess management's compliance with applicable written plans, policies, procedures, and programs; and

(d) the deficiencies related to the board of directors' oversight of management noted in the Report of the Examination of the Bank conducted by the Reserve Bank and the Banking Department in October 2002 (the "Report of Examination").

3. (a) The Bank shall take all available actions as are necessary to increase the number of outside directors to include a minimum of three outside directors with banking experience and report quarterly to the Reserve Bank and the Banking Department on efforts to secure new outside directors.

(b) For the purposes of this Agreement, the term: (i) "outside director" is defined as an individual, not an employee or executive officer of Midstate or the Bank, who

owns less than 10 percent of the outstanding voting stock of Midstate or the Bank and who is not related in any manner to any shareholder who owns 10 percent or more of the outstanding voting stock of Midstate or the Bank or any related interest of such a shareholder; and (ii) “executive officer” is defined as set forth in section 215.2(e) of Regulation O of the Board of Governors (12 C.F.R. 215.2(e)).

Audit and Internal Controls

4. Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank and the Banking Department an acceptable written internal audit program that is suitable for the Bank’s risk profile. The program shall, at a minimum, address, consider, and include:

- (a) Generally accepted auditing standards, including, without limitation, the scope and frequency of audits;
- (b) direct lines of reporting between the auditors and the board of directors;
- (c) designation of resources adequate to ensure that internal audits are conducted by qualified staff, are performed for all areas that have been designated as warranting attention, and are completed as scheduled;
- (d) submission to the board of directors or appropriate committee thereof of periodic audit reports and written management responses;
- (e) periodic review of the Bank’s internal controls and information technology function; and
- (f) corrective steps that address the criticisms of the audit function set forth in the Report of Examination.

5. (a) Within 20 days of this Agreement, the Bank shall, jointly with Midstate, engage an independent public accounting firm, acceptable to the Reserve Bank and the Banking Department, to:

- (i) Conduct an audit of Midstate’s and the Bank’s balance sheets and income statements as of December 31, 2002, and issue an opinion on the balance sheets and income statements, in accordance with generally accepted accounting principles, by May 31, 2003;
- (ii) review the adequacy of the Bank’s internal controls and prepare a written report of findings and recommendations (the “Internal Control Report”) by May 31, 2003; and
- (iii) review the Bank’s information technology function.

(b) Within 15 days of engaging the independent firm, the Bank shall submit to the Reserve Bank and the Banking Department an acceptable engagement letter governing the scope and terms of the audit and internal controls review.

(c) Within 10 days of receipt of the independent firm's audit report, any management letter, and Internal Control Report, the Bank shall provide copies to the Reserve Bank and the Banking Department.

(d) Within 45 days of the receipt of the audit report and management letter, the Bank shall provide the Reserve Bank and the Banking Department with an acceptable written plan to correct all deficiencies noted in the audit report or management letter.

6. Within 45 days of the board of directors' receipt of the Internal Control Report, the Bank shall submit to the Reserve Bank and the Banking Department acceptable written procedures designed to strengthen Bank's internal controls and maintain the accuracy of the Bank's books and records. These procedures shall, at a minimum, address, consider, and include:

- (a) The completeness and accuracy of all Bank books and records, including consistent application of generally accepted accounting principles;
- (b) management information systems to ensure that appropriate management personnel receive timely and accurate reports necessary to effectively manage business risks and correct weaknesses and deficiencies;
- (c) appropriate segregation of duties;
- (d) dual controls;
- (e) controls over computer access;
- (f) Internet deposit accounts; and
- (g) corrective steps to address internal control deficiencies noted in the Internal Control Report and the Report of Examination.

Financial Reporting

7. (a) The Bank shall take all actions as are necessary to ensure that all regulatory reports filed by the Bank, including the Consolidated Reports of Income and Condition, accurately reflect the Bank's condition on the dates for which such reports are filed, that all reports are filed in a timely manner, and that all records indicating how such reports are prepared are adequately maintained for supervisory review.

(b) Within 30 days of this Agreement, the Bank shall submit to the Reserve Bank and the Banking Department revised, complete, and accurate Consolidated Reports of Condition and Income for: December 31, 2001; March 31, 2002; June 30, 2002; and September 30, 2002.

Loan Administration

8. Within 45 days of this Agreement, the Bank shall submit to the Reserve Bank and the Banking Department acceptable written procedures to improve the administration of the Bank's loan documentation imaging system. The procedures shall, at a minimum, address the criticisms in the Report of Examination and detail steps the Bank will take to ensure that the imaging process is current and reliable, with all pertinent loan documentation available on a timely basis.

9. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Banking Department an acceptable written loan review program. The program shall be designed to identify, categorize, and monitor problem credits, to assess the overall quality of the Bank's loan portfolio, and to address the loan review deficiencies described in the Report of Examination. The program shall, at a minimum, address, consider, and include the following:

- (a) The review of extensions of credit for compliance with the Bank's loan policies;
- (b) a description of the risk grades to be assigned to each loan;
- (c) the designation of individuals responsible for determining loan grades, who have the requisite educational and professional qualifications to conduct an independent loan review;
- (d) identification of the scope and frequency of loan grading;
- (e) the requirements outlined in Attachment I of the Interagency Policy Statement on the Allowance of Loans and Lease Losses, issued December 21, 1993, addressing the minimum requirements of loan review and credit grading systems;
- (f) procedures to confirm the accuracy of all risk grades assigned by the Bank's loan officers;
- (g) the development of an adequate watch list that includes all classified loans and accurately identifies the Bank's aggregate exposure to each borrower;
- (h) for each loan identified as a watch list loan, a written statement, maintained in the credit file, of the reasons why such loan merits special attention; and
- (i) periodic reporting to the board of directors of the status of the loan reviews and the action(s) taken by management to improve the Bank's position on each loan adversely graded.

Allowance for Loan and Lease Losses

10. (a) The Bank shall maintain, through charges to current operating income, an adequate valuation reserve for loan losses. The adequacy of the reserve shall be determined in light of the volume of criticized loans, the level of past due and nonperforming loans, past loan loss experience, evaluation of the probable losses in the Bank's loan portfolio (including the potential for the existence of unidentified losses in loans adversely classified), the imprecision of loss estimates, the requirements of the Interagency Policy Statements on the Allowance for Loan and Lease Losses, dated December 21, 1993 and July 2, 2001, and examiners' criticisms noted in the Report of Examination. Within 60 days of this Agreement, the Bank shall submit a description of the reserve methodology to the Reserve Bank and the Banking Department. Thereafter, at a minimum on a calendar quarterly basis, the Bank shall conduct an assessment of its loan loss reserve and, within 30 days of the end of each calendar quarter, shall submit to the

Reserve Bank and the Banking Department the quarterly assessment, including the methodology used in determining the amount of the loan loss reserve for that quarter. The Bank shall maintain for subsequent supervisory review documentation to support the methodology used for each quarterly assessment.

Capital

11. Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank and the Banking Department an acceptable plan to achieve and, thereafter, maintain sufficient capital at the Bank. The plan shall, at a minimum, address and consider:

- (a) The Capital Adequacy Guidelines of the Board of Governors for State Member Banks: Risk Based Measures and Tier 1 Leverage Measure (12 C.F.R. Part 208, App. A and B);
- (b) the volume of adversely classified assets;
- (c) the adequacy of the loan loss reserve;
- (d) any planned growth in assets;
- (e) the anticipated level of retained earnings;
- (f) the anticipated and contingent liquidity needs;
- (g) the Bank's risk profile; and
- (h) the source and timing of additional funds needed to fulfill all current and future capital needs of the Bank.

Dividends

12. The Bank shall not declare or pay any dividends without the prior written approval of the Reserve Bank, the Director of the Division of Banking Supervision and Regulation of the Board of Governors, and the Banking Department. All requests for prior approval shall be received by the Reserve Bank and the Banking Department at least 30 days prior to the proposed dividend declaration date and shall contain, but not be limited to, current and projected information on earnings, cash flow, capital, asset quality, and loan loss reserve needs of the Bank.

Bank Premises

13. (a) Within 30 days of this Agreement, the Bank shall submit to the Reserve Bank and the Banking Department a plan to utilize the property located at 2801 West Memorial Drive, Oklahoma City, Oklahoma.

(b) Within 45 days of this Agreement, the Bank shall submit to the Reserve Bank and the Banking Department a complete accounting of the capital improvements and expenses associated with the 2801 West Memorial Drive property.

Affiliate and Insider Transactions

14. (a) The Bank shall not, directly or indirectly, enter into, participate, or in any other manner engage in any transaction with Midstate without the prior written approval of the Reserve Bank and the Banking Department.

(b) Any request for prior approval shall be accompanied by documentation adequate to provide the Reserve Bank and the Banking Department with the details of each proposed transaction, including a full description of the proposed transaction, the purpose(s) of the transaction, the amounts involved, the benefits to be derived by Midstate and the Bank, the proposed transaction's compliance with all applicable laws and regulations, including sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c-1) and Regulation W of the Board of Governors, and other pertinent materials in order to assist in the review of the proposal.

(c) For the purposes of this Agreement, terms: (i) "transaction" shall include, but not be limited to the transfer, contribution, sale or purchase of any asset, the direct or indirect payment of any expense or obligation, the direct or indirect assumption of any liability, the payment of a management or service fee of any nature, or any extension of credit, including

overdrafts; and (ii) “extension of credit” shall be defined as set forth in section 215.3 of Regulation O of the Board of Governors (12 C.F.R. 215.3)

15. (a) The Bank shall not, directly or indirectly, enter into, participate, or, in any other manner, engage in any financial transaction with any of the Bank’s or Midstate’s current or former executive officers, directors, principal shareholders or related interest thereof without the prior written approval of the Reserve Bank and the Banking Department.

(b) Any request for prior approval shall be accompanied by adequate documentation that provides details of each proposed transaction, including a full description of the proposal, the purpose(s) of the transaction, the amounts involved, the benefits to be derived by the Bank, Midstate, or the current or former executive officer, director, principal shareholder or related interest thereof and such other matters that may be pertinent to the proposed payment or transaction to assist the Reserve Bank’s and the Banking Department’s review of each proposal.

(c) For the purposes of this Agreement, the terms: (i) “director”, “principal shareholder”, and “related interest” shall be defined as set forth in section 215.2 of Regulation O of the Board of Governors (12 C.F.R. 215.2); and (ii) “financial transaction” shall include, but is not limited to: an extension of credit; the use of the Bank’s credit card for personal expenses; the payment of money (except for salaries or employee benefits in effect as of the date of this Agreement); the transfer, sale or purchase of any asset; a contract or payment of services; or the Bank’s payment of any obligation of the Bank’s or Midstate’s current or former executive officers, directors, principal shareholders or related interest thereof.

Compensation

16. (a) The Bank shall not, directly or indirectly, increase the salaries, bonuses or directors' fees of or make any other payments, including, but not limited to, the payment of fees, reimbursement of expenses or payment of indebtedness, to or on behalf of any of the Bank's directors or executive officers without the prior written approval of the Reserve Bank and the Banking Department.

(b) Notwithstanding the provisions of this paragraph, the Bank does not need to obtain the prior written approval of the Reserve Bank and the Banking Department for the reimbursement of reasonable expenses that aggregate no more than \$500 per month for each executive officer, provided that such reasonable expenses are incurred in performing routine duties, which have been adequately documented and reported on the Bank's books and records.

(c) Within 120 days of this Agreement, the board of directors shall conduct a review of personnel costs to ensure that all salaries and bonuses paid to the Bank's executive officers are: (i) consistent with safe and sound banking practices and applicable law, regulations, and guidelines; (ii) justified based on the Bank's performance, financial condition, and future prospects; (iii) related to the services actually rendered to the Bank; (iv) paid in accordance with the duties, responsibilities, and obligations of the Bank's executive officers; and (v) preapproved by the board of directors on a regular basis.

(e) Within 150 days of this Agreement, the board of directors shall submit to the Reserve Bank and the Banking Department the findings and conclusions of the review required by this paragraph, along with any proposed written compensation policies and procedures that may be recommended as a result of the review.

Bank Secrecy Act

17. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Banking Department an acceptable revised written compliance program, as required by the applicable provisions of Regulation H of the Board of Governors (12 C.F.R. 208.63) and 31 U.S.C. 5318(h), designed to ensure and maintain compliance with all provisions of the Currency and Foreign Transactions Reporting Act (31 U.S.C. 5311 et seq.) and the accompanying regulations issued by the U.S. Department of the Treasury (31 C.F.R. 103.11 et seq. (collectively referred to as the Bank Secrecy Act (the “BSA”))). The program shall include all elements required by section 203.63 of Regulation H and in particular:

(a) A system of internal controls to ensure compliance with all provisions of the BSA; and

(b) independent testing of compliance with the BSA and all applicable rules and regulations thereof and the identification and reporting of suspicious activity, and ensure that compliance audits are performed frequently, are fully documented, and are conducted with the appropriate segregation of duties.

Compliance with Laws and Regulations

18. The Bank shall immediately take all necessary steps consistent with sound banking practices to correct all violations of laws and regulations set forth in the Report of Examination. In addition, the board of directors shall take all necessary steps to ensure future compliance with all applicable laws and regulations.

Approval of Plans, Policies, Procedures, and Programs

19. The written plans, policies, procedures, and programs, the identification and engagement of the independent consultant and independent accounting firm, and the engagement

letter required by paragraphs 1(a), 4, 5(a), (b), and (d), 6, 8, 9, 11, and 17 of this Agreement, shall be submitted to the Reserve Bank and the Banking Department for review and approval.

Acceptable plans, policies, procedures, and programs, and an acceptable engagement letter shall be submitted within the time periods set forth in the Agreement, and an acceptable independent consultant and independent accounting firm shall be retained within the time period set forth in paragraphs 1(a) and 5(a) of this Agreement. The Bank shall adopt all applicable approved plans, policies, procedures, and programs within 10 days of approval by the Reserve Bank and the Banking Department and then shall fully comply with them. During the term of this Agreement, the approved plans, policies, procedures, programs, and engagement letter shall not be amended or rescinded and the acceptable independent consultant and independent accounting firm shall not be replaced without the prior written approval of the Reserve Bank and the Banking Department.

Compliance with Agreement

20. (a) Within 15 days of this Agreement, the board of directors shall appoint a committee (the "Compliance Committee") to monitor and coordinate the Bank's compliance with the provisions of this Agreement. Upon the appointment of at least two outside directors, the Compliance Committee shall be comprised of a majority of outside directors who are not executive officers or principal shareholders of Midstate or the Bank, as defined in section 215.2(m)(1) of Regulation O of the Board of Governors (12 C.F.R. 215.2(m)(1)). Until the appointment of at least two outside directors, the Compliance Committee shall be chaired by an independent party acceptable to the Reserve Bank and the Banking Department. At a minimum, the Compliance Committee shall keep detailed minutes of each meeting, and shall report its findings to the board of directors on a monthly basis.

(b) Within 30 days after the end of each calendar quarter (March 31, June 30, September 30, and December 31,) following the date of this Agreement, the board of directors shall furnish to the Reserve Bank and the Banking Department written progress reports detailing the form and manner of all actions taken to secure compliance with this Agreement and the results thereof. Such reports may be discontinued when the corrections required by this Agreement have been accomplished and the Reserve Bank and the Banking Department have, in writing, released the Bank from making further reports.

Communications

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

- (a) Susan E. Zubradt
Vice President
Federal Reserve Bank of Kansas City
925 Grand Boulevard
Kansas City, Missouri 64198
- (b) Mr. Mick Thompson
Oklahoma State Bank Commissioner
Oklahoma State Banking Department
4545 N. Lincoln Boulevard, Suite 164
Oklahoma City, Oklahoma 73105
- (c) Mr. R. Stephen Carmack
Chairman and Chief Executive Officer
Legacy Bank
P.O. Box 1038
Hinton, Oklahoma 73047-1038

Miscellaneous

22. Notwithstanding any provision of this Agreement to the contrary, the Reserve Bank and the Banking Department may, in their sole discretion, grant written extensions of time to the Bank to comply with any provision of this Agreement.

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

24. Each provision of this Agreement shall remain effective and enforceable until stayed, modified, terminated or suspended by the Reserve Bank and the Banking Department.

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

Conversion to State Nonmember Bank

26. It is understood that the Bank is seeking to convert to a state nonmember bank with the approval of the Federal Deposit Insurance Corporation. In the event of the Bank's successful conversion, it is understood and agreed that:

- (a) The provisions of this Agreement will have no further force and effect as to the Board of Governors or the Reserve Bank; and
- (b) all provisions of this Agreement will remain in full force and effect as to the Banking Department.

27. This Agreement is a "written agreement" for the purposes of, and is enforceable by the Board of Governors as an order issued under, section 8 of the FDI Act (12 U.S.C. 1818).

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the 1st day of March, 2003.

Legacy Bank

By:

Samuel Carmack
in protest

Federal Reserve Bank of Kansas City

By:

Alicia E. Zuluaga

Oklahoma State Banking Department

By:

Walter Long