

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

**WASHINGTON STATE DEPARTMENT OF FINANCIAL INSTITUTIONS
OLYMPIA, WASHINGTON**

In the Matter of

PIERCE COUNTY BANCORP
Tacoma, Washington

PIERCE COMMERCIAL BANK
Tacoma, Washington

Docket Nos. 09-174-B-HC
09-174-B-SM

Cease and Desist Order Issued
Upon Consent Pursuant to the
Federal Deposit Insurance Act, as
Amended

WHEREAS, in recognition of their common goal to maintain the financial soundness of Pierce County Bancorp, Tacoma, Washington (“Bancorp”), a registered bank holding company, and its subsidiary bank, Pierce Commercial Bank, Tacoma, Washington (the “Bank”), a state chartered bank that is a member of the Federal Reserve System, Bancorp and the Bank have consented to the issuance of a Cease and Desist Order (the “Order”) by the Board of Governors of the Federal Reserve System (the “Board of Governors”), and the Washington State Department of Financial Institutions (the “DFI”);

WHEREAS, the Bank originated a large volume of residential mortgage loans through a mortgage banking division of the Bank;

WHEREAS, the Bank has sold the mortgage banking division and is taking steps to correct deficiencies in its residential mortgage underwriting, consumer compliance, and operational risk management; and

WHEREAS, on November 30, 2009, the boards of directors of Bancorp and the Bank, at duly constituted meetings, adopted resolutions authorizing and directing Gary T. Gahan to enter into this Order on behalf of Bancorp and the Bank, and consenting to compliance by Bancorp and the Bank, and their institution-affiliated parties, as defined in sections 3(u) and 8(b)(3) of the Federal Deposit Insurance Act, as amended (the “FDI Act”) (12 U.S.C. §§ 1813(u) and 1818(b)(3)), and waiving any and all rights that Bancorp and the Bank may have pursuant to section 8 of the FDI Act (12 U.S.C. § 1818) to: (i) the issuance of a notice of charges on any and all matters set forth in this Order; (ii) an administrative hearing for the purpose of taking evidence on any matters set forth in this Order or the issuance of a recommended order; (iii) judicial review or appeal of this Order; (iv) contest the issuance of this Order by the Board of Governors and the DFI; and (v) challenge or contest, in any manner, the basis, issuance, validity, terms, effectiveness or enforceability of this Order or any provisions hereof.

NOW, THEREFORE, IT IS HEREBY ORDERED that pursuant to sections 8(b)(1) and (3) of the FDI Act (12 U.S.C. §§ 1818(b)(1) and 1818(b)(3)), Bancorp, the Bank, and their respective institution-affiliated parties shall cease and desist and take affirmative action as follows:

Board Oversight

1. Within 60 days of this Order, the Bank’s board of directors shall submit to the Federal Reserve Bank of San Francisco (the “Reserve Bank”) and the DFI a written plan to strengthen board oversight of the management and operations of the Bank. The plan shall, at a minimum, address, consider, and include:

(a) The actions that the board of directors will take to improve the Bank's condition and maintain effective control over, and supervision of, the Bank's senior management and major operations and activities, including but not limited to, residential mortgage lending, internal audit, operational risk, compliance, earnings, capital, and liquidity;

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

(c) the establishment of controls to ensure Bank staff's adherence to approved policies and procedures, and compliance with laws and regulations;

(d) a description of the information and reports that will be regularly reviewed by the board of directors in its oversight of the operations and management of the Bank, including information on the Bank's residential mortgage loan activities, internal audit, operational risk, compliance, earnings, capital, and liquidity; and

(e) the establishment of formal tracking and follow-up procedures to ensure corrective actions are promptly taken to resolve audit and regulatory findings.

Corporate Governance and Management Review

2. (a) Within 30 days of this Order, the Bank's board of directors shall retain an independent consultant acceptable to the Reserve Bank and the DFI to conduct a review of the effectiveness of the Bank's corporate governance and management structure (the "Review") and to prepare a written report of findings and recommendations (the "Report"). The Review shall, at a minimum, address, consider, and include:

(i) the qualifications and performance of each of the Bank's senior executive officers to determine whether the individual possesses the

ability, experience, and other qualifications to competently perform present and anticipated duties, including the individual's ability to: adhere to applicable laws and regulations and the Bank's established policies and procedures; restore and maintain the Bank to a safe and sound condition; and comply with the requirements of this Order;

- (ii) the identification of present and future management and staffing needs for each area of the Bank, particularly in the areas of residential mortgage lending, consumer compliance, operational risk management, and internal audit; and
- (iii) an assessment of the current structure and composition of the board of directors and its committees, and a determination of the structure and composition needed to adequately supervise the affairs of the Bank.

(b) Within 10 days of the Reserve Bank's and the DFI's approval of the independent consultant selection, the Bank shall submit an engagement letter to the Reserve Bank and the DFI for approval. The engagement letter shall require the independent consultant to submit the Report within 30 days of regulatory approval of the engagement letter and to provide a copy of the Report to the Reserve Bank and the DFI at the same time that it is provided to the Bank's board of directors.

3. Within 30 days of receipt of the Report, the board of directors shall submit a written management plan to the Reserve Bank and the DFI that fully addresses the findings and recommendations in the Report and describes the specific actions that the board of directors

proposes to take in order to strengthen the Bank's management and corporate governance, and to hire, as necessary, additional officers or staff.

Loan Portfolio Growth

4. (a) As of the date of this Order, the Bank shall not underwrite or originate any residential mortgage loans without the prior written approval of the Reserve Bank and the DFI.

(b) The restrictions of paragraphs 4(a) of this Order shall continue in force and effect until the Bank:

- (i) submits to the Reserve Bank and the DFI the written policies, procedures, programs, and plan relating to residential mortgage lending, compliance, internal audit, operational risk, and conflicts of interest described in paragraphs 5, 6, 7, 9, and 16 of this Order, and a written plan to manage the growth in the Bank's loan portfolio;
- (ii) is notified in writing by the Reserve Bank and the DFI that the aforesaid policies, procedures, programs, and plan are acceptable;
- (iii) adopts and takes acceptable steps to implement the aforesaid policies, procedures, program, and plan; and
- (iv) is notified in writing by the Reserve Bank and the DFI that the above described conditions have been met.

Loan Policies and Procedures

5. Within 60 days of this Order, the Bank shall submit to the Reserve Bank and the DFI acceptable written loan policies and procedures that shall, at a minimum, address, consider, and include:

(a) Underwriting standards that are appropriate for each type of loan product offered by the Bank, comply with the Real Estate Lending and Appraisal Standards set forth in Subpart E and Appendix C of Regulation H of the Board of Governors (12 C.F.R. Part 208, Subpart E and Appendix C), and include and provide for, at a minimum:

- (i) analysis of the financial capacity of the borrower and, as applicable, any guarantor;
- (ii) documented sources of repayment;
- (iii) cash flow analysis;
- (iv) cash equity requirements;
- (v) loan to value ratio parameters; and
- (vi) current valuation of underlying collateral.

(b) a complete description of loan documentation and collateral required for each specific type of loan;

(c) the review of each loan before closing to ensure that all required documentation to support the Bank's underwriting requirements is accurate and present;

(d) maintenance of all required documentation in the loan files;

(e) procedures for renewing, extending, or modifying existing loans, including procedures for documenting the basis for each renewal, extension, or modification; and

- (f) controls to ensure uniform adherence to all loan policies and procedures.

Consumer Compliance Program

6. Within 60 days of this Order, the Bank shall submit to the Reserve Bank and the DFI an acceptable written consumer compliance program that is commensurate with the Bank's consumer compliance risk profile, its current size, and future growth strategies. The program shall set forth the accountability structure for the Bank's day-to-day consumer compliance activities, and shall, at a minimum, address, consider, and include:

- (a) The responsibilities and authority of senior management to maintain an effective consumer compliance program;
- (b) sufficient resources to ensure that the Bank has an effective consumer compliance program;
- (c) comprehensive policies and procedures to establish a robust consumer compliance program;
- (d) controls to reasonably prevent instances of non-compliance and identify any errors that do occur;
- (e) training of all current and prospective employees and officers that engage in, manage, or oversee, residential mortgage lending, on the Bank's policies and procedures related to consumer compliance laws and regulations;
- (f) the establishment of information systems and the enhancement of periodic written compliance reporting to the board of directors and senior management designed to ensure that:
 - (i) the board of directors possesses the information needed to carry out its responsibility to provide effective oversight of the

Bank's consumer compliance program and the Bank's compliance with the Bank's policies and procedures and applicable consumer protection laws and regulations; and

- (ii) the Bank's senior management possesses the information needed to manage compliance with the Bank's policies and procedures, and consumer protection laws and regulations on a day-to-day basis.

Internal Audit

7. Within 60 days of this Order, the Bank shall submit to the Reserve Bank and the DFI an acceptable enhanced written internal audit program that shall, at a minimum, provide for:

- (a) Improved oversight of all aspects of the audit program by the board of directors' audit committee;
- (b) an enhanced audit committee charter and audit-related policies;
- (c) timely engagement of an independent firm, or staff independent of the function being audited, to provide internal audit services;
- (d) completion, at least annually, of a written, board approved, risk-based audit plan that encompasses both safety and soundness and consumer compliance requirements;
- (e) controls to ensure that audits are completed on a timely basis in accordance with the approved audit plan;
- (f) requirements for detailed, comprehensive audit reports and adequate work papers from the independent firm and/or staff;
- (g) timely resolution of audit findings and follow-up reviews to ensure completion of corrective measures; and

(h) comprehensive tracking and reporting of the status and resolution of audit and examination findings.

Operational Risk

8. Within 30 days of the Bank's receipt of the report from the independent consulting firm previously approved by the Reserve Bank and the DFI to assess the Bank's operational risk and exposure to off balance sheet risks, the Bank shall submit an acceptable written plan to the Reserve Bank and the DFI to address the findings and recommendations.

Capital Plan

9. Within 60 days of this Order, Bancorp and the Bank shall jointly submit to the Reserve Bank and the DFI an acceptable written plan to maintain sufficient capital at the Bank. The plan shall, at a minimum, address, consider, and include:

(a) The Bank's current and future capital needs, including compliance with the Capital Adequacy Guidelines for State Member Banks: Risk-Based Measure and Tier 1 Leverage Measure, Appendices A and B of Regulation H of the Board of Governors (12 C.F.R. Part 208, App. A and B);

(b) the adequacy of the Bank's capital, taking into account the volume of classified credits, concentrations of credit, allowance for loan and lease losses, current and projected asset growth, and projected retained earnings;

(c) the source and timing of additional funds to fulfill the Bank's future capital requirements and loan loss reserve needs; and

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

10. Bancorp and the Bank shall notify the Reserve Bank and the DFI, in writing, no

more than 30 days after the end of any quarter in which any of the Bank's capital ratios (total risk-based, Tier 1 risk-based, or leverage) fall below the approved capital plan's minimum ratios. Together with the notification, Bancorp and the Bank shall submit an acceptable written plan that details the steps Bancorp and the Bank will take to increase the Bank's capital ratios to or above the approved capital plan's minimums.

Liquidity/Funds Management

11. Within 60 days of this Order, the Bank shall submit to the Reserve Bank and the DFI an acceptable written plan designed to improve management and reporting of the Bank's liquidity position and funds management practices.

12. Within 30 days of this Order, the Bank shall submit to the Reserve Bank and the DFI an acceptable revised written contingency funding plan that includes, at a minimum:

(i) analysis of additional liquidity sources; and (ii) adverse scenario analyses, including but not limited to the potential repurchase of loans, to assess possible liquidity events that the Bank may encounter and identify responses to the potential impact of such events on the Bank's short-term, intermediate-term, and long-term liquidity profile.

Strategic Plan and Budget

13. (a) Within 90 days of this Order, the Bank shall submit to the Reserve Bank and the DFI a strategic plan to improve the Bank's earnings and a budget for 2010. The written plan and budget shall include, but not be limited to:

- (i) identification of the major areas where, and means by which, the board of directors will seek to improve the Bank's operating performance;
- (ii) a realistic and comprehensive budget for calendar year 2010,

- including income statement and balance sheet projections; and
- (iii) a description of the operating assumptions that form the basis for, and adequately support, major projected income, expense, and balance sheet components.

(b) A strategic plan and budget for each calendar year subsequent to 2010 shall be submitted to the Reserve Bank and the DFI at least 30 days prior to the beginning of that calendar year.

Dividends and Distributions

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

(b) Bancorp shall not directly or indirectly take dividends or any other form of payment representing a reduction in capital from the Bank without the prior written approval of the Reserve Bank and the DFI.

(c) Bancorp shall not make any distributions of interest, principal, or other sums on subordinated debentures without the prior written approval of the Reserve Bank, the Director, and the DFI.

(d) All requests for prior approval shall be received by the Reserve Bank and the DFI at least 30 days prior to the proposed dividend declaration date and proposed distribution on subordinated debentures. All requests shall contain, at minimum, current and projected information on Bancorp’s capital, earnings, and cash flow; the Bank’s capital, asset quality, earnings, and allowance for loan and lease losses; and identification of the sources of funds for the proposed payment or distribution. For requests to declare or pay dividends, Bancorp and the

Bank must also demonstrate that the requested declaration or payment of dividends is consistent with the Board of Governors' Policy Statement on the Payment of Cash Dividends by State Member Banks and Bank Holding Companies, dated November 14, 1985 (Federal Reserve Regulatory Service, 4-877 at page 4-323).

Debt and Stock Redemption

15. (a) Bancorp shall not, directly or indirectly, incur, increase, or guarantee any debt without the prior written approval of the Reserve Bank and the DFI. All requests for prior written approval shall contain, but not be limited to, a statement regarding the purpose of the debt, the terms of the debt, and the planned source(s) for debt repayment, and an analysis of the cash flow resources available to meet such debt repayment.

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

Conflicts of Interest Policy

16. Within 60 days of this Order, the Bank shall submit to the Reserve Bank and the DFI an acceptable written code of ethics and conflicts of interest policy applicable to the Bank's directors, officers, employees, and contractors ("Covered Persons") to set out the fiduciary duties of all Covered Persons and the avoidance of conflicts of interest. The code of ethics and conflicts of interest policy shall be suitable for the activities and structure of the Bank. The policy, at a minimum, shall address, consider, and include:

- (a) The duty of care and loyalty owed by Covered Persons to the Bank;
- (b) the avoidance of conflicts of interest and the appearance of a conflict of interest;
- (c) the designation of a person, or persons (Ethics Officer), responsible for

developing, implementing, and administering the Bank's code of ethics and conflicts of interest policy;

(d) a requirement that a Covered Persons identify and promptly report to the Ethics Officer situations involving potential conflicts of interest;

(e) a requirement that a Covered Person not participate in the underwriting, approval, or renewal of any loan, the proceeds of which are transferred to or used for the tangible economic benefit of such Covered Person or related interest thereof;

(f) internal controls that monitor compliance with the code of ethics and conflicts of interest policy, investigate allegations of misconduct, and report any noncompliance or exceptions to the policy to the board of directors; and

(g) training for all Covered Persons within 60 days of approval of the policy.

Compliance with Laws and Regulations

17. The Bank shall immediately take all necessary steps to correct all violations of law and regulation cited in the Reserve Bank's supervisory letter dated October 2, 2009, including violations involving the flood insurance provisions of Regulation H, the disclosure provisions of Regulation Z, data reporting errors under Regulation C – the Home Mortgage Disclosure Act, and other violations of the technical provisions of Regulation B. In addition, the board of directors of the Bank shall take the necessary steps to ensure the Bank's future compliance with all applicable laws and regulations.

18. In appointing any new director or senior executive officer, or changing the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position, Bancorp and the Bank shall comply with the notice provisions of

section 32 of the FDI Act (12 U.S.C. § 1831i) and Subpart H of Regulation Y of the Board of Governors (12 C.F.R. §§ 225.71 *et seq.*).

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

Progress Reports

20. Within 30 days after the end of each calendar quarter following the date of this Order, Bancorp and the Bank shall submit to the Reserve Bank and the DFI written progress reports detailing the form and manner of all actions taken to secure compliance with this Order and the results thereof.

Approval and Implementation of Plans, Policies, Procedures, and Programs

21. (a) Bancorp and the Bank, as applicable, shall submit written plans, policies, procedures, program, and an engagement letter, that are acceptable to the Reserve Bank and the DFI within the applicable time periods set forth in paragraphs 2(b), 5, 6, 7, 8, 9, 10, 11, 12, and 16 of this Order. An independent consultant acceptable to the Reserve Bank and the DFI shall be retained in the time period set forth in paragraph 2(a).

(b) Within 10 days of approval by the Reserve Bank and the DFI, Bancorp and the Bank, as applicable, shall adopt the approved plans, policies, procedures, and programs. Upon adoption, Bancorp and the Bank, as applicable, shall promptly implement the approved plans, policies, procedures, and programs and thereafter fully comply with them.

(c) During the term of this Order, the approved plans, policies, procedures, and programs shall not be amended or rescinded without the prior written approval of the Reserve Bank and the DFI.

Communications

22. All communications regarding this Order shall be sent to:
 - (a) Mr. Kevin Zerbe
Vice President
Banking Supervision and Regulation
Federal Reserve Bank of San Francisco
101 Market Street, Mail Stop 920
San Francisco, California 94105
 - (b) Ms. Tracy Bassinger
Vice President
Banking Supervision and Regulation
Federal Reserve Bank of San Francisco
101 Market Street, Mail Stop 920
San Francisco, California 94105
 - (c) Mr. Brad Williamson
Director of Banks
Washington State Department of Financial Institutions
150 Israel Road
Tumwater, Washington 98501
 - (d) Mr. Gary T. Gahan
President and Chief Executive Officer
Pierce Commercial Bank
1722 South Union Avenue
Tacoma, Washington 98405

Miscellaneous

23. Notwithstanding any provision of this Order to the contrary, the Reserve Bank and the DFI may, in their sole discretion, grant written extensions of time to Bancorp and the Bank to comply with any provision of this Order.
24. The provisions of this Order shall be binding upon Bancorp, the Bank, and their institution-affiliated parties, in their capacities as such, and their successors and assigns.
25. Each provision of this Order shall remain effective and enforceable until stayed, modified, terminated, or suspended in writing by the Reserve Bank and the DFI.
26. The provisions of this Order shall not bar, estop or otherwise prevent the Board of

Governors, the Reserve Bank, the DFI or any other federal or state agency from taking any other action affecting Bancorp, the Bank, or any of their current or former institution-affiliated parties and their successors and assigns.

By Order of the Board of Governors of the Federal Reserve System and the DFI effective this 4th day of December, 2009.

PIERCE COUNTY BANCORP

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

By: /s/ Gary T. Gahan
Gary T. Gahan
President & CEO

By: /s/ Jennifer J. Johnson
Jennifer J. Johnston
Secretary of the Board

PIERCE COMMERCIAL BANK

WASHINGTON STATE DEPARTMENT OF
FINANCIAL INSTITUTIONS

By: /s/ Gary T. Gahan
Gary T. Gahan
President & CEO

By: /s/ Brad Williamson
Brad Williamson
Director – Division of Banks