

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

STATE OF SOUTH DAKOTA
DEPARTMENT OF REVENUE AND REGULATION
DIVISION OF BANKING
PIERRE, SOUTH DAKOTA

Written Agreement by and among

FARMERS STATE BANK
Faith, South Dakota

FEDERAL RESERVE BANK OF
MINNEAPOLIS
Minneapolis, Minnesota

and

STATE OF SOUTH DAKOTA
DEPARTMENT OF REVENUE AND
REGULATION—DIVISION OF BANKING
Pierre, South Dakota

Docket No. 10-064-WA/RB-SM

WHEREAS, in recognition of their common goal to maintain the financial soundness of Farmers State Bank, Faith, South Dakota (the “Bank”), a state bank that is a member of the Federal Reserve System, the Bank, the Federal Reserve Bank of Minneapolis (the “Reserve Bank”), and the State of South Dakota Department of Revenue and Regulation, Division of Banking (“Division”) have mutually agreed to enter into this Written Agreement (the “Agreement”); and

WHEREAS, on July 15, 2010, the board of directors of the Bank, at a duly constituted meeting, adopted a resolution authorizing and directing Morris Gustafson to

enter into this Agreement on behalf of the Bank, and consenting to compliance with each and every provision of this Agreement 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)).

NOW, THEREFORE, the Bank, the Reserve Bank, and the Division agree as follows:

Board Oversight

1. Within 60 days of this Agreement, the board of directors of the Bank shall submit to the Reserve Bank and the Division 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 major operations and activities, including but not limited to, credit risk management, lending, credit administration, capital, liquidity, and earnings;

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

(c) 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 problem loans, allowance for loan and lease losses, capital, liquidity, and earnings.

Credit Risk Management

2. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written plan to strengthen credit risk management practices. The plan shall, at a minimum, address, consider, and include:

- (a) The responsibility of the board of directors to establish appropriate risk tolerance guidelines and risk limits;
- (b) periodic review and revision of risk exposure limits to address changes in market conditions; and
- (c) strategies to minimize credit losses and reduce the level of problem assets.

Credit Administration

3. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written credit administration program that shall, at a minimum, address, consider, and include:

- (a) Enhanced, documented analysis of loan performance;
- (b) improvements to the loan collateral valuation process, including enhanced, well documented inspections, conducted at appropriate intervals, and revaluations based on appropriate rationale;
- (c) steps to increase adherence to loan documentation requirements and to limit technical exceptions;
- (d) standards for renewing, extending, or modifying existing loans, including, but not limited to, analysis, documentation, and approval requirements; and
- (e) the provision of appropriate training for all employees involved in the lending process.

Loan Review Program

4. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank an acceptable written program for strengthening internal review and grading of the Bank's loan portfolio by a qualified independent party or by staff that is independent of the Bank's lending function. The program shall, at a minimum, address, consider, and include:

- (a) The scope and frequency of loan review;
- (b) standards and criteria for assessing the credit quality of loans;
- (c) application of loan grading standards and criteria to the loan portfolio, including procedures to re-evaluate loans in the event of material changes in the borrower's performance or value of the collateral; and
- (d) procedures and controls to ensure the consistent adherence to the loan grading standards and criteria and the revised review program.

Asset Improvement

5. The Bank shall not, directly or indirectly, extend, renew, or restructure any credit to or for the benefit of any borrower, including any related interest of the borrower, whose loans or other extensions of credit are criticized in the report of examination of the Bank conducted by the Reserve Bank and the Division that commenced on September 21, 2009 (the "Report of Examination") or in any subsequent report of examination, without the prior approval of a majority of the full board of directors or a designated committee thereof. The board of directors or its committee shall document in writing the reasons for the extension of credit, renewal, or restructuring, specifically certifying that: (i) the Bank's risk management policies and practices for loan workout activity are acceptable; (ii) the extension of credit is necessary to improve and protect the Bank's interest in the ultimate collection of the credit already granted and maximize

its potential for collection; (iii) the extension of credit reflects prudent underwriting based on reasonable repayment terms and is adequately secured; and all necessary loan documentation has been properly and accurately prepared and filed; (iv) the Bank has performed a comprehensive credit analysis indicating that the borrower has the willingness and ability to repay the debt as supported by an adequate workout plan, as necessary; and (v) the board of directors or its designated committee reasonably believes that the extension of credit will not impair the Bank's interest in obtaining repayment of the already outstanding credit and that the extension of credit or renewal will be repaid according to its terms. The written certification shall be made a part of the minutes of the meetings of the board of directors or its committee, as appropriate, and a copy of the signed certification, together with the credit analysis and related information that was used in the determination, shall be retained by the Bank in the borrower's credit file for subsequent supervisory review. For purposes of this Agreement, the term "related interest" is defined as set forth in section 215.2(n) of Regulation O of the Board of Governors of the Federal Reserve System ("Board of Governors") (12 C.F.R. § 215.2(n)).

6. (a) Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written plan designed to improve the Bank's position through repayment, amortization, liquidation, additional collateral, or other means on other real estate owned ("OREO"), and on each loan, relationship, or other asset in excess of \$250,000 that is past due as to principal or interest more than 90 days as of the date of this Agreement, is on the Bank's problem loan list, or was adversely classified in the Report of Examination.

(b) Within 30 days of the date that the Bank acquires OREO, or any additional loan, relationship, or other asset in excess of \$250,000 becomes past due as to principal or interest for more than 90 days, is on the Bank's problem loan list, or is adversely classified in

any subsequent report of examination of the Bank, the Bank shall submit to the Reserve Bank and the Division an acceptable written plan to improve the Bank's position on such loan, relationship, or asset.

(c) Within 30 days after the end of each calendar quarter thereafter, the Bank shall submit a written progress report to the Reserve Bank and the Division to update each asset improvement plan, which shall include, at a minimum, the carrying value of the loan or other asset and changes in the nature and value of supporting collateral, along with a copy of the Bank's current problem loan list, a list of all loan renewals and extensions without full collection of interest in the last quarter, and past due/non-accrual report.

Allowance for Loan and Lease Losses

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

(b) Within 60 days of this Agreement, the Bank shall review and revise its allowance for loan and lease losses ("ALLL") methodology consistent with relevant supervisory guidance, including the Interagency Policy Statements on the Allowance for Loan and Lease Losses, dated July 2, 2001 (SR 01-17 (Sup)) and December 13, 2006 (SR 06-17), and the findings and recommendations regarding the ALLL set forth in the Report of Examination, and submit a description of the revised methodology to the Reserve Bank and the Division. The revised ALLL methodology shall be designed to maintain an adequate ALLL and shall address,

consider, and include, at a minimum, the reliability of the Bank's loan grading system, the volume of criticized loans, concentrations of credit, the current level of past due and nonperforming loans, past loan loss experience, evaluation of probable losses in the Bank's loan portfolio, including adversely classified loans, and the impact of market conditions on loan and collateral valuations and collectibility.

(c) Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written program for the maintenance of an adequate ALLL. The program shall include policies and procedures to ensure adherence to the revised ALLL methodology and provide for periodic reviews and updates to the ALLL methodology, as appropriate. The program shall also provide for a review of the ALLL by the board of directors on at least a quarterly calendar basis. Any deficiency found in the ALLL shall be remedied in the quarter it is discovered, prior to the filing of the Consolidated Reports of Condition and Income, by additional provisions. The board of directors shall maintain written documentation of its review, including the factors considered and conclusions reached by the Bank in determining the adequacy of the ALLL. During the term of this Agreement, the Bank shall submit to the Reserve Bank and the Division, within 30 days after the end of each calendar quarter, a written report regarding the board of directors' quarterly review of the ALLL and a description of any changes to the methodology used in determining the amount of the ALLL for that quarter.

Capital Plan

8. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division 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, ALLL, current and projected asset growth, and projected retained earnings; and

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

9. The Bank shall notify the Reserve Bank and the Division 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, or leverage) fall below the approved capital plan's minimum ratios. Together with the notification, the Bank shall submit an acceptable written plan that details the steps the Bank will take to increase the Bank's capital ratios to or above the approved capital plan's minimums.

Earnings Plan and Budget

10. (a) Within 90 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division a written business plan for the remainder of 2010 to improve the Bank's earnings and overall condition. The plan, at a minimum, shall provide for or describe:

(i) a realistic and comprehensive budget for the remainder of 2010,

including income statement and balance sheet projections; and

(ii) a description of the operating assumptions that form the basis for, and adequately support, major projected income, expense, and balance sheet components.

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

Liquidity/Funds Management

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

(a) Measures to enhance the monitoring, measurement, and reporting of the Bank's liquidity to the board of directors; and

(b) specific liquidity targets and parameters and the maintenance of sufficient liquidity to meet contractual obligations and unanticipated demands.

12. Within 60 days of this Agreement, the Bank shall submit to the Reserve Bank and the Division an acceptable written contingency funding plan that, at a minimum, identifies available sources of liquidity and includes adverse scenario planning.

Dividends

13. (a) The Bank shall not declare or pay any dividends without the prior written approval of the Reserve Bank, the Director of the Division of Banking Supervision and Regulation of the Board of Governors (the "Director"), and the Division.

(b) All requests for prior written approval shall be received at least 30 days prior to the proposed dividend declaration date. All requests shall contain, at a minimum, current and projected information on the Bank's capital, asset quality, earnings, and ALLL needs; and identification of the sources of funds for the proposed payment. 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).

Compliance with Laws and Regulations

14. (a) The Bank shall take all necessary steps to correct all violations of law or regulation cited in the Report of Examination. In addition, the Bank shall take necessary steps to ensure future compliance with all applicable laws and regulations.

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

(c) 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).

Approval and Implementation of Plans and Program

15. (a) The Bank shall submit written plans and programs that are acceptable to the Reserve Bank and the Division within the applicable time periods set forth in paragraphs 2, 3, 4, 6 (a), 6 (b), 7(c), 8, 11 and 12 of this Agreement.

(b) Within 10 days of approval by the Reserve Bank and the Division, the Bank shall adopt the approved plans and programs. Upon adoption, the Bank shall implement the approved plans and programs and thereafter fully comply with them.

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

Progress Reports

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

Communications

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

(a) Ms. Diann G. Townsend
Assistant Vice President
Federal Reserve Bank of Minneapolis
90 Hennepin Avenue
Minneapolis, Minnesota 55401-1804

(b) Mr. Timothy Ahartz
Deputy Director of Banking
South Dakota Department of Banking
217 ½ West Missouri Avenue
Pierre, South Dakota 57501-4590

- (c) Mr. Morris Gustafson
President
Farmers State Bank
127 Main Street
Faith, South Dakota 57626

Miscellaneous

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

19. 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.

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

21. The provisions of this Agreement shall not bar, estop, or otherwise prevent the Board of Governors, the Reserve Bank, the Division, 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.

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

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed as of the 23rd day of July, 2010.

FARMERS STATE BANK

FEDERAL RESERVE BANK
OF MINNEAPOLIS

By: /s/ Morris Gustafson
Morris Gustafson
President

By: /s/ James M. Barnes
James M. Barnes

STATE OF SOUTH DAKOTA
DEPARTMENT OF REVENUE
AND REGULATION DIVISION OF
BANKING

By: /s/ Timothy Ahartz
Timothy Ahartz