

FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON, D.C.

AND

STATE OF ILLINOIS

DEPARTMENT OF FINANCIAL AND PROFESSIONAL REGULATION

DIVISION OF BANKING

SPRINGFIELD, ILLINOIS

_____ )	
In the Matter of )	CONSENT ORDER
)	
MCHENRY SAVINGS BANK )	
MCHENRY, ILLINOIS )	FDIC-10-832b
)	2010-DB-104
(ILLINOIS CHARTERED )	
INSURED SAVINGS BANK) )	
_____ )	

McHenry Savings Bank, McHenry, Illinois ("**Bank**"), having been advised of its right to a NOTICE OF CHARGES AND OF HEARING detailing the unsafe or unsound banking practices and violations of law or regulation alleged to have been committed by the Bank, and of its right to a hearing on the charges under section 8(b) of the Federal Deposit Insurance Act ("**Act**"), 12 U.S.C. § 1818(b), and under Sections 9009, 9015, 9018, 11001, and 11002 of the Savings Bank Act ("**SBA**"), 205 ILCS 205/9009, 9015, 9018, 11001 and 1102, and having waived those rights, entered into a STIPULATION AND CONSENT TO THE ISSUANCE OF A CONSENT ORDER ("**STIPULATION**") with representatives of the Federal Deposit

Insurance Corporation ("FDIC") and the Illinois Department of Financial and Professional Regulation, Division of Banking, ("Division"), dated December 8, 2010, whereby, solely for the purpose of this proceeding and without admitting or denying the charges of unsafe or unsound banking practices and violations of law or regulation relating to Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk, the Bank consented to the issuance of a CONSENT ORDER ("ORDER") by the FDIC and the Division.

The FDIC and the Division considered the matter and determined that they had reason to believe the Bank had engaged in unsafe or unsound banking practices and therefore accepted the STIPULATION.

Having also determined that the requirements for issuance of an order under 12 U.S.C. § 1818(b) and the SBA, 205 ILCS 205/1001 et seq., have been satisfied, the FDIC and the Division **HEREBY ORDER** that the Bank, its institution-affiliated parties, as that term is defined in section 3(u) of the Act, 12 U.S.C. § 1813(u), or in Sections 1007.05 and 11005 of the SBA, 205 ILCS 205/1007.05 and 11005, and its successors and assigns, take affirmative action as follows:

MANAGEMENT

1. (a) During the life of this ORDER, and consistent with the Management Plan required under Paragraph 2 of this

ORDER, the Bank shall have and retain qualified management. Management shall be provided the necessary written authority to implement the provisions of this ORDER. The qualifications of management shall be assessed on its ability to:

- (i) Comply with the requirements of this Order;
- (ii) Operate the Bank in a safe and sound manner;
- (iii) Comply with applicable laws, rules, and regulations; and
- (iv) Restore all aspects of the Bank to a safe and sound condition, including capital adequacy, asset quality, management effectiveness, earnings, liquidity, and sensitivity to interest rate risk.

MANAGEMENT STUDY

2. (a) Within thirty (30) days after the effective date of this ORDER, the Bank shall retain an independent third party acceptable to the Regional Director and the Division. The independent third party shall develop a written analysis and assessment of the Bank's senior executive management and staffing needs ("**Management Plan**") for the purpose of providing qualified management for the Bank.

(b) The Bank shall provide the Regional Director of the FDIC Chicago Regional Office ("**Regional Director**") and the Division with a copy of the proposed engagement letter or contract with the independent third party for review before it is executed.

(c) The Management Plan shall be developed within ninety (90) days after the effective date of this ORDER. The Management Plan shall include, at a minimum:

- (i) Identification of both the type and number of senior executive officer positions needed to properly manage and supervise the affairs of the Bank;
- (ii) Identification and establishment of such Bank committees as are needed to provide guidance and oversight to active management;
- (iii) Evaluation of all Bank senior executive officers to determine whether these individuals possess the ability, experience and other qualifications required to perform present and anticipated duties, including adherence to the Bank's established policies and practices, and restoration and

maintenance of the Bank in a safe and sound condition; and

- (iv) Evaluation of all Bank senior executive officer's compensation, including salaries, director fees, and other benefits; and
- (v) A plan to recruit and hire any additional or replacement personnel with the requisite ability, experience and other qualifications to fill those senior executive officer positions identified in the Management Plan.

(d) The Management Plan shall be submitted to the Regional Director and the Division for review and comment upon its completion. The Bank shall approve the Management Plan, and record its approval in the minutes of the board of directors' meeting. Thereafter, the Bank, its directors, officers, and employees shall implement and follow the Management Plan and/or any subsequent modification.

#### BOARD PARTICIPATION

3. (a) As of the effective date of this ORDER, the Bank's board of directors shall increase its participation in the affairs of the Bank, assuming full responsibility for the approval of sound policies and objectives and for the

supervision of all of the Bank's activities, consistent with the role and expertise commonly expected for directors of Banks of comparable size. This participation shall include meetings to be held no less frequently than monthly at which, at a minimum, the following areas shall be reviewed and approved: reports of income and expenses; new, overdue, renewal insider, charged off, and recovered loans; concentration of credit monitoring reports; investment activity; liquidity monitoring; capital enhancement planning; operating policies; individual committee reports; audit reports; internal control reviews including management's responses; reconciliation of general ledger accounts; and compliance with this ORDER. Board minutes shall document these reviews and approvals, including the names of any dissenting directors.

(b) Within Forty-five (45) days from the effective date of this ORDER, the Bank's board of directors shall develop, adopt, and implement a program that will provide for monitoring of the Bank's compliance with this ORDER. This shall include a committee that consists of at least three outside board members.

(c) Following the required date of compliance with subparagraph (b) above, the Bank's board of directors shall review the Bank's compliance with this ORDER and record its review in the minutes of each regularly scheduled monthly board of directors' meeting.

DIRECTORS AND SENIOR EXECUTIVE OFFICERS

4. During the life of the ORDER, prior to the addition of any individual to the board of directors or the employment of any individual as a senior executive officer, the Bank shall request and obtain the Division's written approval. For purposes of this ORDER, "senior executive officer" is defined as in section 32 of the Act ("**section 32**"), 12 U.S.C. § 1831 (i), and section 303.101 (b) of the FDIC Rule and Regulations, 12 C.F.R. § 303.101 (b).

CAPITAL

5. (a) Within ninety (90) days from the effective date of this ORDER the Bank shall have and maintain its level of Tier 1 capital as a percentage of its total assets ("**capital ratio**") at a minimum of nine percent (9%) and its level of qualifying total capital as a percentage of risk-weighted assets ("**total risk based capital ratio**") at a minimum of twelve percent (12%). For purposes of this ORDER, Tier 1 capital and total assets shall be calculated in accordance with Part 325 of the FDIC Rules and Regulations ("**Part 325**"), 12 C.F.R. Part 325.

(b) Any subsequent increase in Tier 1 capital may be accomplished by the following:

- (i) The sale of common stock and noncumulative perpetual preferred stock

constituting Tier 1 capital under Part 325;

- (ii) The elimination of all or part of the assets classified "Loss" at the Joint FDIC and Division Examination which began on April 5, 2010 ("ROE"), without loss or liability to the Bank, provided any such collection on a partially charged-off asset shall first be applied to that portion of the asset which was not charged off pursuant to this ORDER;
- (iii) The collection in cash of assets previously charged off;
- (iv) The direct contribution of cash by the directors and/or the shareholders of the Bank;
- (v) Any other means acceptable to the Division and Regional Director; or
- (iv) Any combination of the above means.

(c) If all or part of any subsequent increase in capital required by this paragraph is to be accomplished by the sale of new securities, the board of directors of the Bank shall adopt and implement a plan for the sale of such additional securities, including the voting of any shares owned or proxies



held by or controlled by them in favor of said plan. Should the implementation of the plan involve public distribution of Bank securities, including a distribution limited only to the Bank's existing shareholders, the Bank shall prepare detailed offering materials fully describing the securities being offered, including an accurate description of the financial condition of the Bank and the circumstances giving rise to the offering, and other material disclosures necessary to comply with Federal securities laws. Prior to the implementation of the plan and, in any event, not less than twenty (20) days prior to the dissemination of such materials, the materials used in the sale of the securities shall be submitted to the FDIC Registration and Disclosure Section, 550 17<sup>th</sup> Street, N.W., Washington, D.C. 20429 for its review. Any changes requested to be made in the materials by the FDIC shall be made prior to their dissemination.

(d) In complying with the provisions of this paragraph, the Bank shall provide to any subscriber and/or purchaser of Bank securities written notice of any planned or existing development or other changes which are materially different from the information reflected in any offering materials used in connection with the sale of Bank securities. The written notice required by this paragraph shall be furnished within ten (10) calendar days of the date any material

development or change was planned or occurred, which is earlier, and shall be furnished to every purchaser and/or subscriber of the Bank's original offering materials.

DIVIDEND RESTRICTION

6. As of the effective date of this ORDER, the Bank shall not declare or pay any dividend without the prior written consent of the Regional Director and the Division.

LOSS CHARGE OFF

7. As of the effective date of this ORDER, the Bank shall charge off from its books and records any asset classified "Loss" in the ROE.

REDUCTION OF DELINQUENCIES AND CLASSIFIED ASSETS

8. (a) Within sixty (60) days from the effective date of this ORDER, the Bank shall adopt, implement, and adhere to, a written plan to reduce the Bank's risk position in each asset in excess of \$250,000 which is, delinquent or classified "Substandard" or "Doubtful" in the ROE. The plan shall include, but not be limited to, provisions which:

- (i) Prohibit an extension of credit for the payment of interest, unless the Board provides, in writing, a detailed explanation of why the extension is in the best interest of the Bank;

- (ii) Provide for review of the current financial condition of each delinquent or classified borrower, including a review of borrower cash flow and collateral value;
- (iii) Delineate areas of responsibility for loan officers;
- (iv) Establish dollar levels to which the Bank shall reduce delinquencies and classified assets within six (6) and twelve (12) months from the effective date of this ORDER; and
- (v) Provide for the submission of monthly written progress reports to the Bank's board of directors for review and notation in minutes of the meetings of the board of directors.

(b) As used in this paragraph, "reduce" means to: (1) collect; (2) charge off; (3) sell; or (4) improve the quality of such assets so as to warrant removal of any adverse classification by the FDIC and the Division.

(c) A copy of the plan required by this paragraph shall be submitted to the Regional Director and the Division.

(d) While this ORDER remains in effect, the plan shall be revised to include assets which become delinquent after the effective date of this ORDER or are adversely classified at any subsequent examinations.

PROHIBITION OF ADDITIONAL LOANS TO CLASSIFIED BORROWERS

9. (a) As of the effective date of this ORDER, the Bank shall not extend, directly or indirectly, any additional credit to, or for the benefit of, any borrower who is already obligated in any manner to the Bank on any extension of credit (including any portion thereof) that has been charged off the books of the Bank or classified "Loss" in the ROE, so long as such credit remains uncollected.

(b) As of the effective date of this ORDER, the Bank shall not extend, directly or indirectly, any additional credit to, or for the benefit of any borrower whose loan or other credit has been classified "Substandard," "Doubtful," or is listed for "Special Mention" in the ROE and is uncollected unless the Board has adopted, prior to such extension of credit, a detailed written statement giving the reasons why such extension of credit is in the best interest of the Bank. A copy of the statement shall be signed by each Director, and incorporated in the minutes of the applicable board of directors' meeting. A copy of the statement shall be placed in the appropriate loan file.

ALLOWANCE FOR LOAN AND LEASE LOSSES

10. (a) Effective immediately upon the effective date of this ORDER, the Bank shall book a provision for the inadequate Allowance for Loan and Lease Losses ("ALLL") of at least \$4,000,000. This amount must be reflected in an amended March 31, 2010 Report of Condition and Income. Thereafter, the Bank shall ensure that the ALLL is adequately funded at all times.

(b) Within sixty (60) days from the effective date of this ORDER, the Board shall ensure the establishment of a comprehensive policy and methodology for determining the adequacy of the ALLL. The Bank shall address ALLL methodology deficiencies identified in the ROE, within the policy. The policy shall provide for a review of the ALLL at least once each calendar quarter and be completed at least ten (10) days prior to the end of each quarter in order that the results of the review conducted by the board may be properly reported in the quarterly Reports of Condition and Income. Such reviews shall, at a minimum, ensure compliance with the following:

- (i) The Federal Financial Banks Examination Council's Instructions for the Reports of Condition and Income;
- (ii) The Interagency Statement of Policy on the Allowance for Loan and Lease Losses; applicable accounting guidance, including

- Financial Accounting Standards Board  
Accounting Standards Codification ("FASB  
ASC") Subtopic 450-10 and FASB ASC  
Subtopic 310-10 (which now supersede  
prior FAS 5 and 114 guidelines; and
- (iii) Other applicable regulatory guidance that  
addresses the adequacy of the Bank's  
allowance.

INVESTMENT PORTFOLIO VALUATION

11. (a) Within thirty (30) days from the effective date of this ORDER, the Bank shall retain an independent outside firm, acceptable to the Regional Director and the Division, to perform a Fair Market Value ("FMV") and Other-Than-Temporary Impairment ("OTTI") valuation of all investment securities currently held by the Bank.

(b) The firm retained shall have the requisite expertise to perform such valuations and the Bank shall provide the Regional Director and the Division with a copy of the proposed engagement letter or contract with the firm for review.

(c) The methodologies utilized to determine FMV and OTTI valuations shall minimally involve multiple, independent sources of information for pricing securities; shall fully document the sources, adjustments, and assumptions made; and shall be conducted in conformance with all applicable FASB ASC.

(d) The new FMV and OTTI assessment valuations of Bank investment securities shall be prepared as of March 31, 2010 and quarterly thereafter.

(e) A copy of the completed FMV and OTTI assessments shall be provided to the Regional Director and the Division for review and comment.

#### INVESTMENT PORTFOLIO MANAGEMENT

12. (a) Within sixty (60) days from the effective date of this ORDER, the Bank shall adopt and implement revisions to its investment policies, internal control procedures, and Management Information System reporting requirements as necessary to fully correct and/or address all investment management deficiencies identified in the ROE.

(b) Said revisions of investment policy and procedures shall, at a minimum, include the following:

- (i) Methodologies acceptable to the Regional Director and the Division, as determined at subsequent examinations or visitations, for establishing the current FMV of all investment securities owned by the Bank consistent with regulatory guidance;
- (ii) Procedures for the timely identification and ongoing monitoring of all investment securities with a FMV less than amortized cost;

- (iii) Minimally, a quarterly written and fully documented review and evaluation of each security held with a FMV below amortized cost to determine whether its decline in value involves OTTI as determined by calculation and evaluation in accordance with FASB ASC 320 10, ASC 820 10, and ASC 325 40;
- (iv) Any specific investment determined to be subject to OTTI classification shall be written down by the amount of credit loss identified, as determined by compliance with the FASB ASC Guidance above, and recognized in the quarter in which the loss occurred;
- (v) Once OTTI loss has been recognized with regard to a specific investment, the resulting risk-related value shall be the new basis of the asset which shall not be adjusted by subsequent recoveries of value.
- (vi) Risk-based capital treatment of securities, especially for those that have been downgraded by any of the Nationally Recognized Statistical Rating Organizations and/or are in below investment grade categories, shall be



appropriately recorded in the Reports of Condition and Income.

VIOLATIONS

13. (a) Within sixty (60) days from the effective date of this ORDER, the Bank shall eliminate and/or correct all violations of law, rule, and regulation listed in the ROE.

(b) Within ninety (90) days from the effective date of this ORDER, the Bank shall implement procedures to ensure future compliance with all applicable laws, rules, and regulations.

LOAN POLICY

14. (a) Within ninety (90) days from the effective date of this ORDER, and annually thereafter, the board of directors of the Bank shall review the Bank's loan policy and procedures for adequacy and, based upon this review, shall make all appropriate revisions to the policy necessary to strengthen lending procedures and abate additional loan deterioration.

(b) The initial revisions to the Bank's loan policy required by this paragraph, at a minimum, shall include provisions which:

- (i) Establish review and monitoring procedures for compliance with the FDIC's regulation on appraisals, 12 C.F.R. Part 323;

- (ii) Designate the Bank's normal trade area;
- (iii) Establish review and monitoring procedures to ensure that all lending personnel are adhering to established lending procedures and that the directorate is receiving timely and fully documented reports on loan activity, including any deviations from established policy;
- (iv) Require a nonaccrual policy in accordance with the Federal Financial Institutions Examination Council's Instructions for the Consolidated Reports of Condition and Income;
- (v) Require accurate reporting of past due loans to the loan committee on at least a monthly basis;
- (vi) Prohibit the capitalization of interest or loan-related expenses unless the board of directors provides, in writing, a detailed explanation of why said deviation is in the best interest of the Bank;

- (vii) Require strict guidelines and review of out-of-territory loans which, at a minimum, shall include complete credit documentation, full underwriting by the Loan Committee, and approval by a majority of the board of directors prior to disbursement of funds, documentation of Bank expertise in the management of the loan or product, and a detailed written explanation of why the loan is in the best interest of the Bank;
- (viii) Address concentrations of credit and diversification of risk, including goals for portfolio mix, establishment of limits within loan and other asset categories;
- (ix) Establish guidelines for timely recognition of loss through charge-off;
- (x) Establish standards for initiating collection efforts; and
- (xi) Prohibit the payment of any loan through the use of overdrafts.

(c) The revisions to the Bank's loan policy and practices shall also incorporate the items discussed in the ROE.

(d) The board of directors shall approve the written loan policy and any subsequent modification thereto, which approval shall be recorded in the minutes of a board of directors' meeting. Thereafter, the Bank shall implement and follow the amended written loan policy.

LOAN REVIEW AND GRADING SYSTEM

15. Within ninety (90) days from the date of this ORDER, the Bank shall implement revised comprehensive loan grading and review procedures. The procedures shall require that such loan grading and review will be performed by a qualified individual. The loan review shall at a minimum:

(a) Require periodic confirmation of the accuracy and completeness of the watch list and all risk grades assigned by the Bank's loan officers;

(b) Identify loans or relationships that warrant special attention of management;

(c) Identify violations of law, rules, or regulations and credit and collateral documentation exceptions and track corrective measures;

(d) Review the bank's application of FASB ASC Subtopic 310-10 (which now supersedes prior FAS 114 guidelines); and

(e) Identify loans not in conformance with the Bank's loan policy.

ADHERENCE TO CALL REPORT INSTRUCTIONS

16. As of the effective date of this ORDER, the Bank shall amend their Reports of Condition and Income to comply with recommendations in the ROE. The Bank shall continue to file these Reports in accordance with Call Report Instructions each calendar quarter.

CONCENTRATION OF CREDIT

17. Within sixty (60) days from the effective date of this ORDER, the Bank shall formulate, adopt, and implement a written plan to manage the concentration of credit identified in the ROE in a safe and sound manner. At a minimum, the plan must provide for written procedures for the ongoing measurement and monitoring of the concentration of credit, and shall set limits on concentrations commensurate with the Bank's capital position, safe and sound banking practices, and the overall risk profile of the Bank.

PROFIT PLAN AND BUDGET

18. (a) Within ninety (90) days from the effective date of this ORDER, the Bank shall adopt, implement, and adhere to a written profit plan and a realistic, comprehensive budget for all categories of income and expense for calendar year 2011. The plans required by this paragraph shall contain formal goals and strategies, consistent with sound banking practices, to reduce discretionary expenses and to improve the Bank's overall

earnings, and shall contain a description of the operating assumptions that form the basis for major projected income and expense components.

(b) The written profit plan shall address, at a minimum:

- (i) Realistic and comprehensive budgets;
- (ii) A budget review process to monitor the income and expenses of the Bank to compare actual figures with budgetary projections;
- (iii) Identification of major areas in, and means by which, earnings will be improved; and
- (iv) A description of the operating assumptions that form the basis for and adequately support major projected income and expense components.

(c) During each monthly board meeting following completion of the profit plans and budgets required by this paragraph, the Bank's board of directors shall evaluate the Bank's actual performance in relation to the plan and budget, record the results of the evaluation, and note any actions taken by the Bank in the minutes of the board of directors' meeting at which such evaluation is undertaken.

(d) A written profit plan and budget shall be prepared for each calendar year for which this ORDER is in effect.

(e) Copies of the plans and budgets required by this paragraph shall be submitted to the Regional Director and the Division.

#### GROWTH PLAN

19. During the life of this ORDER, the Bank shall not increase its total assets by more than 1.25% during any consecutive three-month period, with the sole exception of providing for adequate liquidity as required by the Consent Order dated October 29, 2010, without providing, at least thirty (30) days prior to its implementation, a growth plan to the Regional Director and the Division. Such growth plan, at a minimum, shall include the funding source to support the projected growth, as well as the anticipated use of funds. This growth plan shall not be implemented without the prior written consent of the Regional Director and the Division. For the purpose of this paragraph, "total assets" shall be defined as in the Federal Financial Institutions Examination Council's Instructions for the Consolidated Reports of Condition and Income.

#### STRATEGIC PLAN

20. Within ninety (90) days from the effective date of this

ORDER, the Bank shall formulate and adopt a realistic, comprehensive strategic plan. The plan required by this paragraph shall contain an assessment of the Bank's current financial condition and market area, and a description of the operating assumptions that form the basis for major projected income and expense components.

(a) The written strategic plan shall address, at a minimum:

- (i) Strategies for increasing and maintaining adequate capital;
- (ii) Strategies for pricing policies and asset/liability management;
- (iii) Strategies for maintaining adequate liquidity; and
- (iv) Financial goals, including pro forma statements for asset growth, capital adequacy, and earnings.

(b) The Bank will submit the strategic plan to the Regional Director and the Division for review and comment. After consideration all such comments, the Bank shall approve the plan, which approval shall be recorded in the minutes of a board of directors' meeting.

(c) Within thirty (30) days from the end of each calendar quarter following the effective date of this ORDER, the



Bank's board of directors shall evaluate the Bank's actual performance in relation to the strategic plan required by this paragraph and record the results of the evaluation, and any actions taken by the Bank, in the minutes of the board of directors' meeting at which such evaluation is undertaken.

(d) The strategic plan required by this ORDER shall be revised and submitted to the Regional Director and the Division for review and comment thirty (30) days prior to the end of each calendar year for which this ORDER is in effect. Within thirty (30) days of receipt of all such comments from the Regional Director and the Division, and after consideration of all such comments, the Bank shall approve the revised plan, which approval shall be recorded in the minutes of a board of directors' meeting. Thereafter, the Bank shall implement the revised plan.

#### NOTIFICATION OF SHAREHOLDER

21. Following the effective date of this ORDER, the Bank shall send to its shareholder a copy of this ORDER: (1) in conjunction with the Bank's next shareholder communication; or (2) in conjunction with its notice of proxy statement preceding the Bank's next shareholder meeting.

PROGRESS REPORTS

22. Within thirty (30) days from the end of each calendar quarter following the effective date of this ORDER, the Bank shall furnish to the Division and Regional Director written progress reports signed by each member of the Bank's board of directors, detailing the actions taken to secure compliance with the ORDER and the results thereof.

CLOSING PARAGRAPHS

The effective date of this ORDER shall be the date of its issuance by the Division and the FDIC.

The provisions of this ORDER shall be binding upon the Bank, its institution-affiliated parties, and any successors and assigns thereof.

The provisions of this ORDER shall remain effective and enforceable except to the extent that, and until such time as, any provision has been modified, terminated, suspended, or set

aside by the Division and the FDIC.

Pursuant to delegated authority.

Dated:

December 14, 2010.

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M. Anthony Lowe  
Regional Director  
Chicago Regional Office  
Federal Deposit Insurance  
Corporation

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Jorge A. Solis  
Director  
Illinois Department of Financial  
and Professional Regulation  
Division of Banking