Contingency Funding Plan

Introductory Overview

On August 26, 2008, the FDIC released a Financial Institution Letter (FIL-84-2008) emphasizing the importance of overall Liquidity Risk Management at financial institutions. Additionally, Interagency Guidance on Funding and Liquidity Risk Management was published April 2010. The FDIC and the Inter-agency guidance outline the expectations of sound management of funding and liquidity risk.

The purpose of the Contingency Funding Plan is to establish procedures that will ensure the liquidity of the bank is properly managed in a stress or crisis situation.

This CFP focuses on both the availability and reliability of the funding sources. Using cash flow projections, the CFP will analyze a base case scenario as well as future funding surpluses and shortfalls under various "stress test" scenarios.

The CFP has been developed in connection with the Asset/Liability Management, Interest Rate Risk Policy and the Brokered Deposits Policy.

Frequency of Revision

The CFP will be reviewed by the ALCO and the Board of Directors on an annual basis or when significant events occur that necessitate a revision, whichever occurs first. Such events include, but are not limited to, the following:

- Significant reduction of the line amount of any individual Wholesale Funding source
- Adverse risk events that affect any of the Wholesale Funding sources (i.e. negative news media, regulatory enforcement actions, etc.)
- Addition of new Wholesale Funding sources
- Additional regulatory guidance

The cash flows for the Stress Event Scenarios will be updated quarterly and reviewed by the ALCO.

Funding Sources

Our bank has historically recognized the need for funding sources that go beyond our most important source – our retail deposit business – and we have created a funding program that identifies various wholesale funding sources that can be used whenever appropriate. We execute a liquidity program today that uses both asset-based and liability-based principles and we do favor retail deposits whenever they are available at efficient cost. In those circumstances where wholesale funding offers either a maturity or cost efficiency not available with retail deposits, we will evaluate and use these sources as part of our normal funding program. Our CFP does correlate to our ALCO policy that states that we will not exceed a ratio of *40%* for wholesale funding as a percent of total assets. Similarly, we have set limits on our wholesale funding sources as follows and our CFP will adhere to these limits:

FUNDING SOURCE	LIMIT (% of ASSETS)
FHLB Advances	**25%**
Brokered Deposits	**25%**
CDARS	**15% (Encompassed in Brokered Limit)**
IDC Deposits	**10% (Encompassed in Brokered Limit)**
Reich & Tang	**10% (Encompassed in Brokered Limit)**
Repurchase Agreements	**15%**
Fed Funds Purchased	**15%**
Internet CDs	**15%**
Federal Reserve Discount Window	**20%**

The reason we have applied generous limits to each source has to do with the fact that different economic environments favor different sources and we want to be able to take advantage of the most economical funding sources as appropriate to manage both our interest rate risk and funding costs. We will, however, not exceed our overall *40%* limit.

Our primary source of funding will be our retail deposit base. We will generate this funding by aggressively marketing in our trade area and by actively seeking demand deposits through service-related tactics and savings deposits through competitive pricing tactics. In the event this source is not an attractive alternative either for reasons of maturity or pricing, we will consider the following sources:

- ***Federal Home Loan Bank Advances*** – we presently have a *$20,000,000* facility with the *FHLB* of *Atlanta* and it is collateralized with *1-4 residential mortgage portfolio and our securities portfolio as appropriate* (**if other collateral is used, indicate this as well).** Our normal collateral position will support *$20,000,000* in borrowings, however, we typically have an additional *$10,000,000* in securities available if needed. We believe that we will always have enough collateral to support total borrowings of *$20,000,000*. Historically, we have borrowed under this facility at the rate of *7%* of assets and our objective for CFP purposes is to always have *$15,000,000* available for a liquidity event. Our contact for funding at *FHLB of Atlanta is Jim Smith* and our contact number is *(800) 856-1000*.

- ***Federal Reserve Bank Discount Window*** – we presently have a *$15,000,000* facility available from the *Federal Reserve Bank of Atlanta*. We have set aside our *commercial loan and credit card portfolios along with some of our securities portfolio* to support this facility and we typically can support up to *$20,000,000* in borrowings. We recognize that this facility will not be priced competitively in normal economic environments and do not expect to use this facility except in times of crisis. As such, this facility will be our key CFP funding source. Based on the history of the Discount Window during the liquidity event period of August 2007 through *June 2008*, it is clear to us that this is our single best source of liquidity in difficult times. Our contact for funding at the *Federal Reserve Bank of Atlanta is Jim Smith at (404) 299-1000*. As this is a facility we do not intend to use in normal times, we will test the facility at least *twice* a year for an overnight borrowing.

- ***Internet CDs*** – we presently have a facility with *QwickRate* where we have been obtaining CD funding since *2005*. Our average funding through *QwickRate* during the past 12 months has been *$5,000,000* and we believe that this source will be available in times of crisis. Though there is no limit set on us by the provider, we believe that cost effectiveness will drive the use of this source. Our contact at *QwickRate* is *Jim Smith* who can be reached at *(800) 233-2333*. Our normal method for using this facility is through the website (*www.qwickrate.com*).

- ***CDARS*** – The Certificate of Deposit Account Registry Service is a form of brokered deposits and we have been involved in this program since *2005*. In addition to allowing us to offer our own clients enhanced FDIC insurance coverage, CDARS also allows us to fund our balance sheet through their One-Way Buy program. This is a competitive bid process conducted each week and we *have not used this process in the past*. Due to the nature of the FDIC basis, we do believe that this will be a viable source of funds in a crisis situation so long as we retain our well-capitalized status and we will test this facility at least *twice* a year. Our contact for CDARS is *Jim Smith* at *(800) 233-2333* (**you may want to use the Funding Desk contact at CDARS for this contact**).

- ***Brokered Deposits*** – we presently have an arrangement with *XXX* that allows us to issue brokered deposits as long as we meet the definition of Well Capitalized. During the past 12 months we have used this facility *3* times in order to raise *$5,000,000*. We view this facility as one that should be used when the retail deposit marketplace is either too expensive or will not provide the kind of maturity we desire to manage our interest rate risk. Our contact and phone number for this facility is *Jim Smith at (800) 233-2333*.

- ***IDC Deposits*** – Institutional Deposits Corp (IDC) provides a facility that allows us to both offer higher FDIC insurance coverage to our money market depositors as well as raise money market funding at competitive rates. *Over the past 12 months, we have used this facility to raise $2,000,000 in deposits* and our contact for this is *Jim Smith at (800) 233-2333*.

- **Reich & Tang –** Reich & Tang provides a facility that allows us to both offer higher FDIC Insurance coverage to our money market depositors as well as raise money market funding at competitive rates. *Over the past 12 months, we have used this facility to raise $2,000,000 in deposits and our contact for this is Jim Smith at (800) 233-2333.*

- ***Repurchase Agreements*** – we presently have a facility with *XXX* that allows us to raise as much as *$10,000,000* by pledging our high quality securities. This facility provides for both overnight and term funding. During the past 12 months, we have used this facility *2* times raising a total of *$3,500,000*. Our Investment Policy provides that we always maintain a ratio of securities/total assets of *10%* and we feel this will provide availability when needed in a liquidity event. In order to support this facility, we have an arrangement with *DTC* to hold these securities when needed for pledging and our contacts for both activities are *Jim Smith at (800) 233-2333 and*

Joe Smith at DTC at (800) 233-2334. If we do not use this facility during a 12-month period for raising funds, we will test it at least *twice* during the year.

- ***Fed Funds Purchased*** – as this funding source is limited in terms of usage, we have arranged for *three* facilities in the total amount of *$9,000,000*. These facilities along with contacts and phone numbers include XXX *(Jim Smith at 800 233-3333), XXX (Joe Smith at 800 233-3334), and XXX (Tim Smith at 800 233-2444)*. During the past 12 months, we have used these facilities *3* times in order to raise *$5,000,000*. In the event we do not use one or more of the facilities, we will test each bank at least *twice* each year.

Role of Securities Portfolio

Our Investment Policy provides for us to always maintain our securities portfolio at no less than *10%* of total assets. We do this in order to make certain we have high quality collateral for pledging as well as for liquidity in times of need. This asset-based liquidity concept complements our liability-based concept as described above and we will liquidate for liquidity purposes if this makes sense from the perspective of profitability and/or cost efficiency.

Role of Loan Participations / Sales

During the normal course of business, we do participate loans when needed and do sell residential mortgages we create if maturity is an issue. Though this technique is quite useful in diversifying risk, we do not believe that the concept works well in a liquidity event. Such an event could be an internal one in which case our credits would be suspect or an external one in which case, there may not be willing buyers. As a result, we do not see this as an effective tool in a Liquidity Crisis.

CFP Team (Role of Board & Senior Management)

The Board of Directors and Management of *First National Bank* recognize the importance of liquidity in the day-to-day operation of our franchise and believe it crucial to have a plan for addressing liquidity in times of crisis. We believe that liquidity crises can occur both from internal as well as external events and our plan addresses both contingencies.

Roles and Responsibilities

The operational responsibility and day-to-day management of the CFP resides with the Chief Financial Officer (CFO) and any support personnel they delegate specific tasks to. Such activities include, but are not limited to, the following:

- Reviewing the Bank's liquidity and cash positions daily
- Monitoring the need for draws on the various Sources of Funding
- Executing the draws and repayment for the various Sources of Funding
- Monitoring any covenant requirements for the various Sources of Funding
- Testing the availability of the various Sources of Funding (See Appendix C)
- Monitoring of triggering events
- Executing precursory action plans

- Reporting to Management, ALCO committee, and Board on adverse risk events or any significant changes in the CFP capacity.

Internal Communications

During a liquidity crisis, the CEO, CFO, and members of the ALCO (Asset/Liability Committee) will be responsible for decision making and implementation of the plan. Special ALCO meetings will be called for the purpose of managing a liquidity crisis and are to be the top priority of all ALCO members.

The Chief Financial Officer will be responsible for executing the specific tasks in the plan as well as delegating to the ALCO members certain duties to carry out the plan.

A list of those individuals authorized to borrow funds on behalf of the Bank from our sources is in Appendix D.

External Communication

In the event of a liquidity crisis, it is critical that a consistent message is communicated to external parties. The Chief Executive Officer will be responsible for drafting the message, and the following First National Bank resources will be responsible for communicating that message:

External Third Party	Primary Resource / Contact	Secondary Resource / Contact
Local News Media	Communications Director	Chief Executive Officer
Wholesale Funding Sources	Chief Financial Officer	Chief Executive Officer
Regulatory Agencies	Chief Executive Officer	Chief Financial Officer
Shareholders	Communications Director	Chief Executive Officer
Significant Customer Relationships	Chief Executive Officer	Relationship Manager

Contact Information

1. President and CEO – XXXX: main constituents are our Regulators, Shareholders and Clients. Address – XXXX, Cell Number – XXXXX.
2. Board Member – XXXX: will keep our Board of Directors current. Address – XXXX, Cell Number – XXXXX.
3. CFO – XXXX: will stay in contact with our Funding Sources and work with CEO with Regulators. Address – XXXX, Cell Number – XXXXX.
4. Communications Director: will work with CEO on communications to Shareholders, Clients, and Local Media. Address – XXXX, Cell Number – XXXXX.
5. Senior Credit Officer: will work with the team on all credit issues if that is the root cause of the liquidity event. Address – XXXX, Cell Number – XXXXX.

(Your team designates may be different, but please cover all of the constituencies you deem appropriate and make sure names, addresses are included.)

This team will also be responsible for communicating with our own staff on a regular and consistent basis so long as the crisis is on going.

Precursory Action Plans

In light of impending liquidity problems, management may take proactive steps to obtain liquidity and funding for the Bank. Management will work to stave off any liquidity and funding problems by taking proactive steps. Liquidity and funding changes in the normal course of business or low volume changes can be handled with relative ease. Significant and sudden changes in liquidity and funding may cause strains on the Bank if management is not prepared accordingly.

The following is a list of precursory action plans:

Precursory action plans – Management

- Execute/Maintain brokered deposit registrations and applications.
- Maintain FHLB membership and application.
- Maintain FRB Primary Credit application.
- Maintain FFLOC agreements.
- Make any necessary collateral pledges.
- Investigate access to capital if needed.
- Notify correspondent banks and other interested parties.

Precursory action plans – Assets

- Discuss cash letter scenarios with correspondent bank.
- Purchase securities for use in pledging.
- Sell securities to roll into fed funds sold.
- Allow securities maturities to roll into fed funds sold.
- Indentify loans that can be sold or participated.
- Indentify loans from the remaining loans that can be pledged.
- Suspend lending activities.

Precursory action plans – Liabilities

- Lengthen term of certificates of deposits.
- Lengthen term of FHLB borrowings.
- Lengthen term of FRB Primary Credit borrowings.
- Purchase brokered deposits for added liquidity.

Crisis Events

We believe that crisis events can be both short and long term and can be created by internal or external situations. At this time, we can visualize several short term scenarios that would revolve around events like Weather Related issues – Hurricanes, Tornados, Floods -, Acts of War, and PR situations that could reflect badly on our institution leading to large deposit withdrawal or withdrawal of funding sources. Longer-term events are seen as ones that severely impact our institution and could lead to failure. By the nature of this event, we see this situation as one involving significant loan or investment losses brought on by economic conditions and/or improper controls. To guard against the latter, our investment policy limits the amount of risk we can take to overnight Fed Funds Sold, Treasury Obligations, Agency Obligations that are "AAA" rated, and Corporate Bonds of at least "A" quality. As we believe the risk in this portfolio to be associated with the last category, we have purposely held no more than 2% of our assets in this type of security. We also see this long term risk as one that could be part of a larger industry-wide demise and recognize that funding ourselves in that scenario could be much more difficult. For purposes of this Plan, we have identified the following indicators as ones that could lead to a liquidity event:

1) (Non Performing Assets / Total Assets) > 5%
    a. NPA = (Non Accruals + 90 > days past due + OREO)
2) (Net Charge Offs / Assets) > 2%
3) Capital Ratios < Well Capitalized
4) Deposit Withdrawal > 10% of Deposits
5) Quarterly Loss caused by Provisioning

(Your bank may identify other events – these are simply examples)

<u>Short Term Crisis</u> – by its nature, a short term crisis would not be one that would typically cut our institution off from our normal funding on an individual basis but rather could lead to systemic risk that affects us along with the market in general. Our plan then in these kinds of situations would be to replenish our funding through the most likely short-term sources of funding that could exist in this situation – Fed Funds Lines and Federal Home Loan DRC Advances. This would be the order in which we replenish and our decision to use one over the other would be based on price efficiency. Based on our experience during the latest liquidity event (Fall, 2008), both of these sources remained viable and hence collateral became the central issue for choosing one over the other. In order to provide a sense of needed funding, we are using the loss of 10% of our assets as the figure needed to replace lost funding and our cash flow scenario is one of five days with the loss of funding starting on day 1.

<u>Longer Term Crisis</u> – unlike the former situation, this kind of event would likely cut us off from several normal sources of funds as our bank's financial situation deteriorated. We believe that of all our funding sources, the Fed Funds lines are most credit sensitive and we do not think that these facilities would be available in this event. Any form of brokered deposit would also be off limits if our event involved the loss of our well- capitalized status. Finally, we also believe that the Repurchase Agreement market would be off limits based on the credit sensitive nature of the 'lenders' in this arena. So, in a longer-term event, our focus would be on Internet CDs (by its nature, this market already operates in the <$250,000 market and is covered under FDIC insurance), Federal Home Loan Bank Advances, and the Federal Reserve Discount

Window. This is also where we might see a desire to liquidate securities but that decision would be based on the expected losses created by such a sale. In order to provide a sense of needed funding, we are using the overall loss of 20% of assets as the figure needed to replace lost funding and we are using the cash flow concept of quarterly deterioration caused by expanding NPA ratios, losses created by ALLL provisioning, and loss of well capitalized status as our triggering events. Each quarter of our monthly cash flow analysis includes one of these events and our task is to find replacement funding that will be available as our condition deteriorates quarter by quarter.

Stress Testing

Our stress testing methodology will consist of three scenarios – our normal and expected cash flow laid out over the next 12 months on a monthly basis, our short term liquidity event which stresses us to locate 10% of our assets (at that time) in new funding, and a longer term crisis in which our stress involves 20% of our assets. During the past *5* years, our bank has never experienced a loss of deposits that exceeded *10%* of our assets and using 10% and 20% of assets appears to us to be a conservative methodology for this exercise. ***(If your experience doesn't include 5 years, use an appropriate time period and if you have actually experienced a loss of deposits over some time period of less than, say, six months, you may have to use higher %'s).*** Our short-term stress test cash flow will describe an event of just 5 days (day by day) duration in which our need for funding is started and finished in that period. Our longer term stress test cash flow will be one of 12 months and will encompass monthly changes in need that accelerate to a high of 20% of assets.

Crisis Management Checklist

Key Board /Management Assignments

- ☐ The CEO or CFO shall be responsible for declaring a crisis.
- ☐ The CEO or CFO shall be responsible for estimating the duration and reporting to the Board about the situation.
- ☐ The CFO shall be responsible for managing the crisis and providing updates to the ALCO and Board.
- ☐ The CFO shall be responsible for executing more sophisticated tools for managing a crisis should they be needed, such as cash flow monitoring, gap reporting and others.

Key Senior Management Assignments

- ☐ CEO or Chief Risk Officer will contact the regulators.
- ☐ CEO or CFO will contact the rating agency if appropriate.
- ☐ The Controller or Chief Risk Officer will contact the external auditors.
- ☐ CEO will have responsibility for asset management.
- ☐ CFO will have responsibility for wholesale funding management.
- ☐ CFO will have responsibility for depositor management.
- ☐ CEO, CFO, or individual officers will have responsibility for contacting significant deposit customers.

Key Wholesale Funding Assignments - CFO

- ☐ Identify wholesale funding sources remaining.
- ☐ Identify possible funding alternative sources.
- ☐ Estimate borrowings to be called.
- ☐ Estimate FRB primary credit borrowing capacity.
- ☐ Estimate brokered deposits that will not be renewed.
- ☐ Estimate FHLB capacity.

Key Asset Liquidity Assignments – CFO & ALCO

- ☐ Identify all cash sources consisting of fed funds and cash balances.
- ☐ Identify a list of all available securities.
- ☐ Identify a list of loans to be participated out to correspondent banks.
- ☐ Identify a list of loans to be sold.
- ☐ Identify any remaining collateral for pledging purposes.
- ☐ Obtain bid values for conversion to cash.

Other Issues for Consideration – Not Part of CFP But Should Be Discussed Internally

The process of creating a Contingency Funding Plan has been a work in progress and new ideas continue to surface that create more challenges. Though for many institutions, the CFP will truly be a "Contingency" event, we also know that other institutions are actually "living" the third scenario right now. For these institutions, "real" experience with funding sources may vary from the above and this information will have to be included in those situations. We know, for instance, that conserving Capital during these difficult times has become a crucial issue and many institutions are reducing the size of their balance sheet as a method for reducing liquidity needs as well as conserving their Capital Ratios. This could alter your CFP. We also know that this CFP is a "living" document and as such must be updated periodically. We suggest that the CFP, particularly as it relates to the stress tests/cash flows, be updated on a quarterly basis. Finally, we also know that as the situation in the economy and in our industry improves, there is a fourth scenario lurking in the wings – what will we do when the equity markets "drain" deposits from our system just as loan demand increases (likely in a dramatic way)? Though we are looking forward to this scenario as it will likely reflect improvements that will be welcomed by all, it will also suggest another cash flow to be considered. Fortunately, our process in scenario 3 is one that could depict either the "Doomsday" event or this improvement scenario as our hypothesis is that we lose 20% of assets in funding and this would likely be similar to the improving event concept. That said, we think it wise to actually create that fourth scenario with a different description from the "Doomsday" event. We believe the cash flow for this scenario will, however, be similar to that 3rd event.