

Sound Community Bank

4. POLICY ON CONFLICTS OF INTEREST, TRANSACTIONS WITH AFFILIATES AND LOANS TO INSIDERS

Approved September 19, 2006

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I. Introduction.

This Policy on Conflicts of Interest, Transactions with Affiliates and Loans to Insiders (the “Policy”) calls to the attention of the directors, officers and employees of Sound Community Bank (the “Savings Association”):

- § the policies of the Savings Association on conflicts of interest and related party transactions;
- § specific regulatory restrictions on extensions of credit and other transactions involving persons and companies that are affiliated with the Savings Association and its affiliates, which the Savings Association must observe strictly; and
- § related record-keeping, disclosure and approval requirements for related party transactions, which must be met by the Savings Association.

All directors and executive officers should receive and read a copy of this Policy and execute the acknowledgment form on the last page. The executive officers of the Savings Association should ensure that all other officers and the non-officer employees of the Savings Association whose responsibilities include matters within the scope of the Policy also receive and read a copy of this Policy. *It is important to note that certain terms used in this Policy have technical definitions in the federal regulations or are specially defined herein. Those definitions are included in Section X of this Policy.*

II. Conflicts of Interest In General.

The Office of Thrift Supervision (the “OTS”), which regulates the Savings Association, has a regulation on conflicts of interest.¹ That regulation requires that all directors, officers and employees of the Savings Association, and others (such as affiliates of the Savings Association), which are in a position to direct the management or policies of the Savings Association, or otherwise owe a fiduciary duty to the Savings Association, do the following:

- § not advance their own interests (business or personal), or those of others with whom they have a business or personal relationship, at the expense of the Savings Association;
- § disclose to the Board of Directors of the Savings Association (the “Board”) all material nonprivileged information relevant to a decision by the Board on a matter or transaction in which they (and, to the extent known to them, persons with whom they have a personal or business relationship) have an interest, including the nature and extent of the interest and the facts known about the matter or transaction, and
- § not participate in the Board’s discussion of any such matter or transaction, and, as to directors of the Savings Association, not vote on that matter or transaction.

It is not possible to list every practice or condition that may give rise to a conflict of interest. At a minimum, the Savings Association’s directors, officers and employees must act in good faith only on behalf of the Savings Association, exercising their appropriate care and

¹ 12 C.F.R. §563.200.

loyalty to the Savings Association. The Savings Association's directors, officers and employees must not act on behalf of themselves or any third parties, especially in transactions that are at the expense of the Savings Association or that constitute self-dealing or self-serving practices. In addition, these individuals must avoid any appearance of a conflict of interest. All directors, officers and employees should notify the President of the Savings Association (or such other person as the President may designate) of any known or potential conflicts of interest.

Transactions between the Savings Association and its affiliates are subject to special rules, described below, which limit such transactions and require that the terms of such transactions be as favorable to the Savings Association as would apply in a transaction with a non-affiliate. Loans and extensions of credit to insiders are also subject to special rules described below, which impose certain limits and requirements on such loans.

III. Restrictions on Transactions With Affiliates.²

The types and amounts of transactions between the Savings Association and its affiliates (as defined in Section X below) are restricted as described below. For purposes of these restrictions, the Savings Association includes its subsidiaries, and a subsidiary generally is not deemed an affiliate, unless it is a depository institution or as otherwise indicated in the definition of affiliate below. In addition, to the extent that the proceeds of a transaction with a non-affiliate are used for the benefit of or are transferred to an affiliate, such transaction is considered to be a transaction with that affiliate, except to the extent that one of the exemptions in 12 C.F.R. §223.16 (b) and (c) (which are not specifically described in this Policy) is in place.

Although under certain circumstances the Savings Association may properly reimburse an affiliate for expenditures made by the affiliate on the Savings Association's behalf, such as the payment of taxes, the Savings Association may not advance funds to the affiliate before they are needed by the affiliate, because advancing funds sooner provides the affiliate with the interest-free use of the Savings Association's funds. Such an advance is regarded by the OTS as an interest-free loan, which is improper because the Savings Association would not make such a loan to a non-affiliate.

A. Covered Transactions.

Covered transactions³ consist of (i) extensions of credit (as defined in Section X below) to an affiliate; (ii) a purchase of an investment in a security issued by an affiliate; (iii) acceptance of securities issued by an affiliate as collateral for an extension of credit to any person or company; (iv) purchases of assets (including assets under an agreement to repurchase) from an affiliate;⁴ (v) guarantees, acceptances and letters of credit (including endorsements and standby

² Sections 23A and 23B of the Federal Reserve Act, Regulation W (12 C.F.R. Part 223), Section 11(a) of HOLA and 12 C.F.R. §563.41. The OTS may impose restrictions on transactions between the Savings Association and its affiliates in addition to those in these laws and regulations in order to protect the safety and soundness of the Savings Association.

³ 12 C.F.R. §223.3(h).

⁴ Unless specifically exempted from the category of covered transactions by order or regulation of the Board of Governors of the Federal Reserve System (the "Federal Reserve").

letters of credit) issued on behalf of an affiliate; (vi) confirmations of a letter of credit issued by an affiliate; and (vii) a cross-affiliate netting arrangement (as defined in Section X below).

B. Quantitative Limits on Covered Transactions.

Covered transactions of the Savings Association with any single affiliate may not exceed, in the aggregate, 10% of the Savings Association's unimpaired capital and surplus.

Covered transactions of the Savings Association with *all* affiliates may not exceed, in the aggregate, 20% of the Savings Association's unimpaired capital and surplus.

C. Safety and Soundness Requirement.

Notwithstanding any authority it has to engage in a transaction with an affiliate, the Savings Association may not engage in any transaction with an affiliate that is inconsistent with safe and sound banking practices.

D. Collateral Requirement for Credit Transactions.⁵

Each credit transaction (as defined in Section X below) with an affiliate must be secured at the time of the transaction by collateral with a market value equal to the amounts described below. The Savings Association must perfect an enforceable security interest in the collateral, which must be valid in bankruptcy, in order for the credit transaction to be considered secured. If this security interest in the collateral is not a first priority security interest, the value of the collateral, for purposes of meeting the required levels noted below, must be reduced by the lesser of the amount of any senior security interest or the amount of the credit secured by that senior security interest. Collateral that is retired or amortized must be replaced so as to maintain the required percentage of collateral market value relative to the outstanding credit. Low-quality assets (as defined in Section X below), securities issued by an affiliate, equity securities of the Savings Association, debt securities of the Savings Association that qualify as capital, intangible assets (including servicing assets) and guarantee issuances are not eligible collateral for meeting this requirement. The required collateral and market value percentages are as follows:

- § 100% of the credit if the collateral consists of (i) obligations of the United States or its agencies; (ii) obligations fully guaranteed as to principal and interest by the United States or its agencies; (iii) notes, drafts, bills of exchange or banker's acceptances eligible for rediscount or purchase by a Federal Home Loan Bank or Federal Reserve Bank, or (iv) a segregated, earmarked deposit account with the Savings Association;
- § 110% of the credit if the collateral consists of obligations of a State or political subdivision of a State;
- § 120% of the credit if the collateral consists of other debt instruments, including loans and receivables, or

⁵ 12 C.F.R. §223.14.

§ 130% of the credit if the collateral consists of stock, leases or other real or personal property.

These collateral requirements *do not* apply to

§ an acceptance already fully secured by attached documents or other property involved in the transaction with an ascertainable market value;

§ the unused portion of an extension of credit to an affiliate, as long as the Savings Association does not have a legal obligation to advance additional funds under the extension of credit until the required collateral is provided, or

§ the purchase from a non-affiliate of a debt security in a bona fide secondary market transaction.

E. No Purchase of Low-Quality Assets.⁶

The Savings Association may not purchase a low-quality asset (as defined in Section X below) from an affiliate unless, pursuant to an independent credit evaluation, the commitment to purchase was made prior to the acquisition of the asset by the affiliate. The provision does not apply to the renewal of or an extension of additional credit with respect to the Savings Association's participation in a loan to a non-affiliate that was originated by an affiliate if:

§ the loan was not a low-quality asset at the time the participation was purchased;

§ the renewal or extension of additional credit is approved by the Board (or as otherwise permitted under 12 C.F.R. §223.15(2)(ii), as necessary to protect the Savings Association's investment by enhancing the ultimate collection of the debt;

§ the Savings Association's share of the renewal or extension of additional credit does not exceed its proportional share of the original indebtedness by more than 5 percent (or any higher level approved by the OTS), and

§ the Savings Association notifies the OTS about the renewal or extension of credit in writing within 20 days of consummation.

F. Additional Prohibited Covered Transactions.⁷

The Savings Association may make an extension of credit directly to an affiliate, only if that affiliate engages *solely* in eligible affiliate activities (as defined in Section X below), which are those activities that are permissible for a bank holding company.

§ An extension of credit to a non-affiliate that benefits an affiliate not engaged solely in eligible affiliate activities is not prohibited by this restriction.

⁶ 12 C.F.R. §223.15.

⁷ 12 C.F.R. §563.41(c).

§ This prohibition includes a purchase of assets subject to the affiliate's agreement to repurchase the assets, unless the purchase involves the U.S. Treasury securities transactions or other asset purchases described in 12 C.F.R. §563.41(c)(1)(ii)(A - C).

The Savings Association may not purchase or invest in any securities issued by any affiliate, other than a subsidiary (including a subsidiary depository institution). In addition, when acting as fiduciary, the Savings Association may not purchase any assets from an affiliate (including securities), unless permitted by the instrument creating the fiduciary relationship, by court order or by the law governing the fiduciary relationship.

G. Valuation and Timing Principles for Credit Transactions.⁸

In determining the application of the quantitative limits on covered transactions, credit transactions are initially valued at the greater of:

- § the principal amount of the transaction;
- § the amount owed by the affiliate, or
- § the sum of the amount already provided to and any amount required to be provided to an affiliate.

An outstanding credit transaction with an affiliate that is purchased or acquired from a non-affiliate is initially valued at the sum of the total consideration given (including liabilities assumed), plus any additional amounts required to be provided to the affiliate.

A credit transaction is deemed to occur at the time:

- § the Savings Association is legally obligated to make an extension of credit or issue a guarantee issuance;
- § the Savings Association enters into a cross-affiliate netting arrangement, or
- § the Savings Association acquires an extension of credit or guarantee issuance.

In general, the Savings Association is not permitted to purchase or invest in debt securities of an affiliate. This prohibition does not apply to debt securities of financial institution subsidiaries or any other subsidiary. The valuation and timing rules for permissible purchases or investments in debt securities of an affiliate are provided in 12 C.F.R. §223.23 (the details of which are not included in this Policy).

If the Savings Association has an outstanding credit transaction with a non-affiliate that becomes an affiliate, the treatment of that credit transaction under the quantitative and collateral requirements is governed by 12 C.F.R. §223.21(b)(2) (the details of which are not included in

⁸ 12 C.F.R. §223.21.

this Policy).

H. Valuation and Timing Principles for Asset Purchases.⁹

Except for the transactions listed below, any asset purchased from an affiliate must be valued initially at the total amount of consideration (including assumed liabilities) given by the Savings Association; however, this valuation may be reduced to reflect amortization or depreciation inconsistent with GAAP.

- § Purchases of extensions of credit to an affiliate are valued as if they were a credit transaction.
- § Permitted purchases of debt securities of affiliates are governed by 12 C.F.R. §223.23.
- § Transfers of subsidiaries of an affiliate to the Savings Association, which became an operating subsidiary, are governed by 12 C.F.R. §223.31 (the details of which are not included in this Policy).
- § Purchases from an affiliate of a line of credit, revolving credit facility or similar credit arrangement with a non-affiliate must be valued at the total consideration given by the Savings Association, plus any additional amounts that the Savings Association may be required to provide under the credit arrangement.

An asset purchase begins the day the asset is acquired and ends when the Savings Association no longer owns or holds the asset.

If the Savings Association purchases an asset from a non-affiliate in contemplation of that non-affiliate becoming an affiliate, the treatment of that asset purchase under the quantitative limits for covered transactions is governed by 12 C.F.R. §223.22(b)(2) (the details of which are not included in this Policy).

I. Valuation and Timing Principles for Extensions of Credit Secured by Affiliate Securities.

If the Savings Association extends credit to a non-affiliate which is secured by debt or equity securities of an affiliate the valuation of that covered transaction is governed by 12 C.F.R. §223.24 (the details of which are not included in this Policy).

J. Exemptions from Certain Limits on Covered Transactions With Affiliates¹⁰

The covered transactions listed below are exempt from the quantitative limits and the collateral requirement, but continue to be subject to the safety and soundness requirement and the low-quality asset prohibition.

⁹ 12 C.F.R. §223.22.

¹⁰ 12 C.F.R. §§223.41-43.

- § Any transaction between the Savings Association and any depository institution, if either entity owns or controls at least 80% of the voting securities of the other, or if the same company controls at least 80% of the voting securities of both of them.
- § The purchase of loans by the Savings Association from an affiliated depository institution without recourse.
- § A purchase assets from an affiliate (including an operating subsidiary acquisition described below) in connection with a transfer of securities issued by an affiliate to the Savings Association, which is part of an internal corporate reorganization of a holding company and otherwise meets all the requirements in 12 C.F.R. §223.41(d)(1)-(7).
- § The purchase of certain marketable securities from an affiliate that is an SEC registered or Federal Reserve approved broker dealer which otherwise meets the requirements in 223.42(f)(1)-(6).

The covered transactions listed below are exempt from the quantitative limits, the collateral requirements and the low quality asset prohibition, but are still subject to the safety and soundness requirement.

- § Correspondent banking deposits by the Savings Association in an affiliated depository institution that represents an ongoing, working balance maintained in the ordinary course of correspondent business.
- § Immediate credit extended by the Savings Association to an affiliate for uncollected items received in the ordinary course of business.
- § Extension of credit to an affiliate to the extent it is and remains secured by obligations of, or fully guaranteed by, the United States and its agencies or a segregated, earmarked deposit amount at the Savings Association for the sole purpose of and identified as securing credit transactions with affiliates.
- § The purchase of any securities of an affiliate engaged solely in the services listed in 12 U.S.C. §1843(c)(1).
- § The purchase from an affiliate of assets with a readily identifiable and publicly available market quotation and purchased at or below the current quotation, which otherwise meets the requirements of 12 C.F.R §223.42(f).
- § The purchase of municipal securities from an affiliate that is an SEC registered or Federal Reserved approved broker dealer which otherwise meets the requirements in 223.42(g)(i)-(3).
- § The purchase from an affiliate of an extension of credit originated by the Savings Association and previously sold to that affiliate subject to a repurchase agreement or under recourse.

- § The purchase of assets from an affiliate by any *de novo* financial institution subsidiary of the Savings Association, if the *de novo* regulator approves the purchase in writing.
- § The acquisition of assets or extensions of credit from an affiliated financial institution, if approved under the Bank Merger Act.
- § Purchasing extensions of credit from an affiliate on a nonrecourse basis, if the other requirements 223.42(k) are met.¹¹
- § Intraday (or one business day) extensions of credit to affiliates, if the other requirements of 223.42(l) are met.
- § The purchase of a security from an affiliate that is SEC registered or Federal Reserve approved broker dealer, if the Savings Association or affiliate acts exclusively as a riskless principal in the transaction and the security is not issued, underwritten or sold (as other than a riskless principal).

The Savings Association may request an exemption from any imposed requirement or limitation on its transactions with affiliates by submitting a written request to the General Counsel of the Federal Reserve, which describes the transaction and affiliate relationship in detail and explains why an exemption is appropriate and is in the public interest and consistent with Section 23A.

K. Special Covered Transactions.

If the Savings Association acquires the securities of an affiliate for consideration (including an assumption of liabilities), and as a result of that acquisition, the affiliate becomes an operating subsidiary of the Savings Association, that transaction will be treated as a purchase of assets subject to the valuation rules and step transaction exemption in 12 C.F.R. §223.31 (the details of which are not included in this Policy).

A derivative transaction includes any derivative contract listed in sections III.E.1.a. through d. of Appendix A to 12 C.F.R. Part 225 and any similar derivative contract, including a credit derivative contract. If the Savings Association engages in any derivative transaction with an affiliate, the transaction must meet the market terms requirement described below. Prior to entering into any derivatives with an affiliate, the Savings Association must establish policies and procedures reasonably designed to manage any credit exposure from such transactions in a safe and sound manner, including ensuring compliance with the market terms requirement described below and monitoring and controlling the credit exposure from derivative transactions with any one affiliate and all affiliates in the aggregate (including specific credit limits, mark-to-market procedures and collateral requirements). In addition, in any credit derivative between the Savings Association and a non-affiliate, by which the Savings Association provides credit protection for an affiliate's obligations shall be treated as a guarantee on behalf of an affiliate. The following agreements are deemed to be credit derivatives providing credit protection for an obligation of an affiliate:

¹¹ This constitutes the exception in former Federal Reserve regulation 250.250.

§ the Savings Association, for a fee, agrees to compensate a non-affiliate for any default of the underlying obligation of an affiliate, or

§ the Savings Association, in exchange for payments based on the total return of the underlying obligation of the affiliate, agrees to pay the non-affiliate a spread over funding costs plus any depreciation in the value of the underlying obligation of the affiliate.

If the Savings Association purchases an asset from one affiliate in a transaction that is subject to an exemption noted above but the continued ownership of the purchased asset by the Savings Association is a covered transaction with a different affiliate, which does not qualify for any exemption, the transaction is only exempt as to the purchase of the asset. All the covered transaction limits will continue to apply as to the holding of the asset.¹²

L. Market Terms Requirement for Transactions With Affiliates¹³

All the transactions with affiliates listed below must be on terms and under circumstances, including credit standards, that are substantially the same as or at least as favorable to the Savings Association as those prevailing at the time for comparable transactions with parties that are not affiliates or, in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to parties that are not affiliates:

§ any covered transaction (except for certain exempt transactions identified in 12 C.F.R. §223.52(a)(1));

§ sale of a security or other asset to an affiliate, including an asset subject to an agreement to repurchase;

§ the payment of money or the furnishing of a service to an affiliate under contract, lease or otherwise; and

§ any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the Savings Association or to any other person.

This market terms requirement also applies to any transaction or series of transactions by the Savings Association with a non-affiliate if:

§ any affiliate has a financial interest in the non-affiliate;

§ any affiliate participates in the transaction or series of transactions, or

§ any proceeds of the transaction are used for the benefit of or are transferred to any affiliate.

¹² 12 C.F.R. §223.71.

¹³ Section 23B of the Federal Reserve Act and 12 C.F.R. §223.51-.52.

M. Prohibited Purchases of Assets as Fiduciary¹⁴

The Savings Association is prohibited from purchasing, as fiduciary, any security or other asset from an affiliate, unless the purchase is permitted under the instrument creating the fiduciary relationship, by court order or by the law of the jurisdiction governing the fiduciary relationship.

The Savings Association is prohibited from knowingly purchasing or otherwise acquiring, as principal or fiduciary, any security during the existence of any underwriting or selling syndicate, if an affiliate is a principal underwriter of the security.¹⁵

N. Prohibited Advertisements and Agreements¹⁶

The Savings Association and its affiliates may not publish any advertisement or enter into any agreement stating or suggesting that the Savings Association will in any way be responsible for the obligations of its affiliates. This restriction does not prohibit the Savings Association from entering into a guarantee issuance or cross-affiliate netting arrangement that otherwise merits all the requirements of this Part III of this policy or from making reference to guarantee issuance a cross-affiliate netting arrangement, if otherwise required by law.

IV. Restrictions on Loans to Insiders.¹⁷

A. Extensions of Credit to Insiders.

Subject to the restrictions listed below, the Savings Association (including its subsidiaries and any company it controls under Part 574 of the OTS) may make an extension of credit (as defined in Section X below) to a director, executive officer (as defined in Section X below) or any other insider (as defined in Section X below) of the Savings Association or an insider of an affiliated company (as defined in Section X below).¹⁸ These extensions of credit to insiders must be made only:

§ upon substantially the same terms (including interest rate and collateral) as comparable transactions with persons who are not insiders or employed by the Savings Association;

¹⁴ 12 C.F.R. §223.53

¹⁵ For purposes of this “principal underwriter” means any underwriter in a primary distribution of securities who (i) is in privity of contract with the issuer or any affiliated person of the issuer; (ii) initiates or directs, along or with others, the formation of an underwriting syndicate, or (iii) is allowed a greater rate of gross commission, spread or other profit greater than another underwriter in the distribution.

¹⁶ 12 C.F.R. §223.54.

¹⁷ Sections 22(g) and (h) of the Federal Reserve Act, 12 C.F.R. Part 215, Section 11(b) of HOLA and 12 C.F.R. §563.43. The OTS may impose restrictions on loans to insiders of the Savings Association in addition to those in the laws and regulations in order to protect the safety and soundness of the Savings Association.

¹⁸ Note in the definitions that for purposes of the restrictions on loans to insiders, executive officer includes the Chairman of the Board.

- § following credit underwriting standards not less stringent than those prevailing for, comparable transactions with persons who are not insiders or employed by the Savings Association, and
- § if the extension of credit does not involve more than normal risk of repayment or present other unfavorable features to the Savings Association.

These restrictions do not apply for extensions of credit to insiders in accordance with a benefit or compensation program involving any extension of credit that is widely available to Savings Association employees, or, in the case of insiders of an affiliated company, to employees of that affiliated company, and that does not give preference to insiders over other employees of the Savings Association or the affiliated company.

These restrictions on extensions of credit to insiders of an affiliated company do not apply if: (i) the affiliated company does not control (as defined in Section X below) the Savings Association and does not have assets constituting 10% or more of the consolidated assets of the Savings Association's ultimate parent holding company, and (ii) the specific insider does not participate in major policy-making functions of the Savings Association and is excluded from doing so by resolution of the Savings Association's Board or the bylaws of the Savings Association.

A participation in an extension of credit sold by the Savings Association without recourse is no longer an extension of credit by the Savings Association.

B. Prior Board Approval.

Prior approval of a majority of the entire Board (excluding any interested director) is required for any extension of credit (including a line of credit) to an insider of the Savings Association or an insider of an affiliated company, if aggregate extensions of credit to such person (including related interests (as defined in Section X below) of such person) exceed either: (i) the greater of \$25,000 or 5% of the Savings Association's unimpaired capital and surplus (as defined in Section X below), or (ii) \$500,000. No interested party may participate directly or indirectly in the Board's discussion, deliberations or voting on the credit, which includes any attempt to influence the voting. Board approval of a line of credit for an insider is valid for 14 months.

C. Additional Limits on Amounts and Purposes of Extensions of Credit to Executive Officers of the Savings Association.¹⁹

Extensions of credit to an executive officer of the Savings Association must be of a type the Savings Association can make to other borrowers and are restricted to the following amounts and purposes:

- § any amount for the purpose of financing the education of the officer's children;

¹⁹ Section 22(g) of the Federal Reserve Act and 12 U.S.C. §215.5.

- § any amount for the purpose of financing or refinancing the purchase, maintenance, construction or improvement of one residence (primary, secondary or vacation) owned by the executive officer, if secured by a first lien on that residence; provided, that only one such residence loan to each insider may be outstanding under this authority at any one time, and a refinancing is limited to the amount of the existing extension of credit, closing costs and any additional amounts for the maintenance or improvement of that residence;
- § in any amount, if the extension of credit is secured by permissible security (as defined in Section X below); and
- § up to 2.5% of the Savings Association's unimpaired capital and surplus in the aggregate (or \$25,000 if higher), but in no event exceeding \$100,000, for any other purpose.

In addition, loans to any partnership in which one or more of the executive officers of the Savings Association are partners or hold a majority interest shall be limited, per partnership, to 2.5% of the Savings Association's unimpaired capital and surplus (or \$25,000 if higher), but in no event more than \$100,000. The total amount of any extension of credit to such a partnership shall be treated for purposes of the similar limitation on loans to individual executive officers as an extension of credit to each executive officer of the Savings Association who is a partner of the partnership.

Before any extension of credit can be made to an executive officer of the Savings Association, the officer must submit a current detailed financial statement. All extensions of credit to executive officers of the Savings Association must be reported promptly to the Board. The Savings Association must have in writing the right to demand immediate repayment of extensions of credit to an executive officer at any time at which that officer is indebted to one or more other savings associations or banks in an aggregate amount greater than the credit the Savings Association could extend to the officer for the same purpose.

Notwithstanding these limits on credit extended to an executive officer of the Savings Association, an executive officer may endorse or guarantee for the protection of the Savings Association any loan or other asset previously acquired by the Savings Association in good faith or may incur an indebtedness to the Savings Association for the purpose of protecting the Savings Association against loss or giving financial assistance to the Savings Association.

D. Overdrafts of Executive Officers and Directors.²⁰

The payment of an overdraft on the account of an executive officer or director of the Savings Association or an affiliated company of the Savings Association requires a written, interest-bearing, preauthorized credit plan that specifies a method of repayment or prior written authorization to transfer funds from another account of the executive officer or director at the Savings Association; provided, however, that inadvertent overdrafts not exceeding \$1,000 in the aggregate may be paid if the account is not overdrawn more than five business days and the Savings Association charges the same fee it charges to outside customers in similar

²⁰ 12 C.F.R. §215.4(e).

circumstances.

E. Limit on Extension of Credit to One Insider.²¹

The limit on extensions of credit to any one insider of the Savings Association or an affiliated company (including all related interests of such an insider) is the Savings Association's general lending limit, which is 15% of the Savings Association's unimpaired capital and surplus for loans not fully secured by readily marketable collateral²² and an additional 10% of unimpaired capital and surplus for loans fully secured by readily marketable collateral.²³

F. Aggregate Limit on Extensions of Credit to Insiders.

Aggregate extensions credit to all insiders of the Savings Association and its affiliated companies (including all related interests of such persons) must not exceed the Savings Association's unimpaired capital and surplus. This limit does not apply to extensions of credit secured by permissible security.

If the Savings Association has deposits of less than \$100 million, the Board, in an annual resolution, may increase this aggregate limit up to two times the Savings Association's unimpaired capital and surplus if:

- § the Board determines this higher level is consistent with prudent, safe and sound banking practices, in light of the Savings Association's experience in insider lending, and is necessary to attract or retain directors or prevent restricting credit in small communities;
- § the Board resolution sets forth the facts and reasoning underlying the Board's decision and the percentage of unimpaired capital and surplus currently outstanding in extensions of credit to insiders;
- § the Savings Association at least meets all applicable fully phased-in capital requirements, and
- § the Savings Association received a satisfactory composite rating in its most recent report of examination.

If the Board authorizes this higher lending amount and the Savings Association subsequently fails to meet the required capital or exam rating requirement, no further extensions of credit to insiders may be made if the aggregate of all such extensions of credit outstanding is more than the Savings Association's unimpaired capital and surplus.

²¹ 12 C.F.R. §215.4(c).

²² To be readily marketable, collateral must have a market value determined by reliable and continuously available price quotations.

²³ Statutory exceptions to this general lending limit in 12 U.S.C. §84 continue to apply for purposes of this limit on loans to insiders.

G. Responsibility of Insiders.²⁴

No executive officer, director or principal shareholder (as defined in Section X below) of the Savings Association or any affiliated company shall knowingly receive or shall knowingly permit that person's related interests to receive, directly or indirectly, any extension of credit from the Savings Association not in compliance with these restrictions on loans to insiders.

V. Kickbacks.²⁵

No officer, director, employee, agent or attorney of the Savings Association may solicit or receive on behalf of himself, herself or any third party (other than the Savings Association) anything of value from any person for or in connection with any transaction, business or confidential information of the Savings Association, whether before or after the consummation of a transaction, except for *bona fide* salary, wages, fees or other compensation paid or reimbursed in the ordinary course of business. Violation of this prohibition can be a criminal offense, and subject to punishment by imprisonment and a fine. Questions about whether an item may be accepted should be directed to the President of the Savings Association or such person as the President may designate. Generally speaking, the following items are *not* prohibited:

- § acceptance of gifts, gratuities, amenities or favors based on obvious family or personal relationships (such as those with parents, children or spouse) when circumstances make it clear that the motivating factor is those relationships, rather than the business of the Savings Association;
- § acceptance of meals, refreshments, travel arrangements or accommodations, or entertainment, all of reasonable value, in the course of a meeting or other occasion, the purpose of which is to hold *bona fide* business discussions or to foster better business relations; provided, however, that the expense would be paid for by the Savings Association as a reasonable business expense if not paid for by another party;
- § acceptance of loans from other financial institutions on customary terms to finance proper and usual activities, such as home mortgage loans;
- § acceptance of advertising or promotional material of reasonable value such as pens, pencils, note pads, key chains, calendars and similar items;
- § acceptance of discounts or rebates on merchandise or services that do not exceed those available to other customers;
- § acceptance of gifts of reasonable value related to commonly recognized events or occasions, such as a promotion, new job, wedding, retirement, Christmas or bar or bat mitzvah, and

²⁴ 12 C.F.R. §215.6.

²⁵ 18 U.S.C. §215; Guidelines for Compliance With the Federal Bank Bribery Law, 52 Fed. Reg. 43941 (1987).

§ acceptance of civic, charitable, educational or religious organizational awards for recognition of service and accomplishment.

If any officer, director, employee, agent or attorney of the Savings Association is offered or sent something of value by a customer or prospective customer of the Savings Association beyond what is authorized herein, that officer, director, employee, agent or attorney must disclose such offer or delivery to the President of the Savings Association or such person as the President may designate. The President or the President's designee shall maintain written records of these disclosures, which will be periodically reported to the Board.

VI. Prohibited Tie-ins.²⁶

The Savings Association may not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the price or other consideration for any of the foregoing, on the condition or requirement:

§ that the customer obtains additional credit, property or service from the Savings Association, or from any subsidiary or affiliate of the Savings Association, other than a loan, discount, deposit, or trust service;

§ that the customer provide additional credit, property or service to the Savings Association, or to any subsidiary or affiliate of the Savings Association, other than those related to and usually provided in connection with a similar loan, discount, deposit, or trust service, or

§ that the customer not obtain some other credit, property or service from a competitor of the Savings Association, or from a competitor of any service corporation or affiliate of the Savings Association, other than a condition or requirement that the Savings Association reasonably imposes in connection with credit transactions to assure the soundness of credit.

In addition, the Savings Association shall not extend credit or otherwise participate in any sale of real property that will be purchased with the assistance of a federally related mortgage (as defined in Section X below), if the Savings Association knows the seller of the property required the purchaser to buy title insurance from a particular title company.

VII. Recordkeeping and Reporting Requirements.

A. Records of Transactions With Affiliates.²⁷

The Savings Association shall establish a list of its affiliates, and management shall cause such list to be updated at least annually. The Savings Association must maintain records of all transactions with affiliates (including transactions with non-affiliates, the proceeds of which are transferred to or used for the benefit of an affiliate). Such records must identify the affiliate; whether the affiliate is engaged solely in eligible activities; the dollar amount of the transaction;

²⁶ 12 U.S.C. §1464(q) and §2608.

²⁷ 12 C.F.R. §563.41(c)(3).

whether at the time of the transaction such amount is within the limits on aggregate transactions with that affiliate and with all affiliates; whether a low-quality asset is involved; whether the collateral requirements for such transaction apply, and, if so, the type and amount of collateral. Such records must also demonstrate how the transaction qualifies as being on substantially the same terms and conditions, including credit standards, as would apply to a non-affiliated party in a comparable transaction (or in the absence of a comparable transaction, terms and conditions that the Savings Association would offer in good faith to such a party).

B. OTS Notification of Affiliate Transactions.²⁸

Unless the OTS indicates otherwise in writing in accordance with 12 C.F.R. §563.41(c)(4)(ii), the Savings Association is not required to notify the OTS before engaging in a transaction with an affiliate or any subsidiary that is not exempt from Regulation W. If such notification is required, the Savings Association must provide at least 30 days notice before engaging in any transaction with an affiliate.

C. Identification of Insiders and Related Interests.²⁹

At least annually, the President of the Savings Association (or such person as he may designate) shall prepare a record of all insiders of the Savings Association and the related interests of such persons. The insiders of the Savings Association shall review this record for completeness and accuracy.

Annually, the Savings Association shall require the insiders of the Savings Association to report their respective related interests. Each insider must report any changes to such reports annually, if such changes occur during the year.

The Savings Association shall identify insiders of its affiliated companies by (i) an annual survey of its affiliated companies and (ii) requiring that each borrower indicate whether he or it is an insider of an affiliated company of the Savings Association.

D. Debts of Executive Officers to Correspondent Banks and Other Banks and Savings Associations.

Each executive officer and principal shareholder of the Savings Association, if any, must make a written report³⁰ to the Board by January 31 of each year for the preceding calendar year concerning certain debts to correspondent banks of the Savings Association. For this purpose, a correspondent bank is a bank (excluding savings associations and certain industrial loan companies) at which the Savings Association has accounts (excluding time deposits at prevailing market rates or accounts maintained in the ordinary course of business for the sole purpose of effecting Federal funds transactions or making Eurodollar placements at prevailing market rates) that in the aggregate during a calendar year, exceed an average daily balance of the lesser of

²⁸ 12 C.F.R. §563.41(c)(4).

²⁹ 12 C.F.R. §215.8.

³⁰ For information on the contents of the report, see 12 C.F.R. §215.22(b).

\$100,000 or 0.5% of the Bank's total deposits (as reported in the first consolidated report of condition for that calendar year).

The debts to be reported include extensions of credit to the executive officer or principal shareholder, and related interests of either, except for:

- § commercial paper, bonds and debentures issued in the ordinary course of business, and
- § consumer credit (as defined in 12 C.F.R. §226.2(a)(12)) in an aggregate amount of \$5,000 or less from an individual correspondent bank, if on terms no more favorable than those offered to the general public.

The report must specify for the executive officer or principal shareholder and each related interest the maximum amount of indebtedness (either during the calendar year or at a month end during the year) to each of the Savings Association's correspondent banks during the calendar year and the amount outstanding as of 10 business days before the report is filed, and describe the terms and conditions including rate (or range of rates), original amount and date, maturity date, payment terms, security and any unusual conditions. The Savings Association must maintain the reports for at least three years, unless the OTS requests that the Savings Association hold them longer.

The Savings Association shall prepare a list of the names and addresses of all correspondent banks and provide it to its executive officers and principal shareholders each year in timely fashion to enable them to prepare the required reports. The reports are not required to be made public or filed with Federal banking regulators, unless specifically requested. However, as discussed below, certain information about debts of executive officers and principal shareholders to correspondent banks must be made public upon request.

In addition, if an executive officer receives extensions of credit from any bank(s) or savings association(s), other than the Savings Association, in an amount greater than the amount of loans and extensions of credit that the Savings Association may make to the executive officer for such category of loans and extensions of credit, then within 10 days after incurring such debt, the executive officer must report to the Board in writing the lender's name, the amount of the debt and the date incurred, any security for the debt and the purpose of the debt.

E. Disclosures to the Public On Request.³¹

Upon receipt of a written request from a member of the public, the Savings Association shall disclose to the requestor the name of each executive officer and principal shareholder (and related interests of either) to whom any correspondent bank of the Savings Association had outstanding at any time during the previous calendar year, extensions of credit that equal or exceed the lesser of 5% of the Savings Association's unimpaired capital and surplus or \$500,000 when aggregated with all outstanding credits to the same executive officer or principal shareholder and such person's related interests; provided, however, no disclosure is required if the aggregate amount of all these extensions of credit does not exceed \$25,000. The specific

³¹ 12 C.F.R. §§215.11 and 215.23.

amounts of individual credits are not required to be disclosed. The Savings Association must maintain a copy of any such request and the disposition of it for two years from the date of the request.

F. Disclosure to OTS.

In each Thrift Financial Report filed with the OTS, the Savings Association must report all extensions of credit by the Savings Association to its executive officers made since the previously filed report. The information included in the special report consists of the number of loans, their total amount, and the range of interest rates.

VIII. Usurpation of Corporate Opportunity.³²

Directors and officers of the Savings Association, and other persons with the power to direct the Savings Association's management or policies, or who otherwise owe a fiduciary duty to the Savings Association, must not take advantage of corporate opportunities belonging to the Savings Association. A corporate opportunity belongs to the Savings Association if it is within the corporate authority of the Savings Association or a subsidiary of the Savings Association and is of present or potential practical advantage to the Savings Association. If a disinterested and independent majority of the Savings Association's directors reject the opportunity as a matter of sound business judgment, after a full and fair presentation of the matter, the OTS will not deem a person to have taken advantage of a corporate opportunity of the Savings Association.

IX. Notice and Sanctions.

This Policy shall be distributed to all directors and officers of the Savings Association and all directors and executive officers of any affiliated company, and to each new director upon election or appointment and each new officer upon his or her employment or promotion. Each director or officer receiving a copy of this Policy, or any amendments thereto, shall sign and date the last page of this Policy and return it to the President or the President's designee.

Violations of this Policy and the related federal laws and regulations referenced in Section XI could jeopardize the good standing and financial health of the Savings Association. The Board views any such violations with utmost concern and may take disciplinary action for such violations. Directors who are found to have willfully violated those laws or regulations may be required (i) to return to the Savings Association any benefits received, and (ii) to resign from the Board. Officers who are found to have willfully violated those laws or regulations (i) may be required to return to the Savings Association any benefits received, and (ii) shall be subject to dismissal.

³² 12 C.F.R. §563.201.

X. Definitions.

A. Affiliate³³

The term “affiliate” means the following:

- § any company that (i) controls the Savings Association, or (ii) is controlled by a company that controls the Savings Association;³⁴
- § a bank or savings association subsidiary of the Savings Association;
- § any company (i) that is controlled directly or indirectly, by a trust or otherwise; by or for the benefit of shareholders who beneficially or otherwise, directly or indirectly, by trust or otherwise, control the Savings Association or a company that controls the Savings Association, or (ii) in which a majority of its directors, general partners or trustees constitute a majority of the persons holding any such office with the Savings Association or a company that controls the Savings Association;
- § any company, including a real estate investment trust, that is sponsored and advised on a contractual basis by the Savings Association or any subsidiary or affiliate of the Savings Association; or any investment company with respect to which the Savings Association or any affiliate thereof serves an investment adviser as defined in §2(a)(2) of the Investment Company Act of 1940, 15 U.S.C. §§80a-2(a)(2);
- § any partnership for which the Savings Association or an affiliate serves as a general partner or for which the Savings Association or affiliate causes any of its directors, officers or employees to serve as a general partner;
- § any company held under merchant banking or insurance company authority as described in more detail in 12 C.F.R. §223.2(a)(9);
- § any subsidiary of any of the above; and
- § any company (i) that the OTS or the Federal Reserve determines by regulation or order to have a relationship with the Savings Association or any subsidiary or affiliate of the Savings Association so as to be an affiliate, or (ii) that the OTS determines, by order or regulation, to present a risk to the safety or soundness of the Savings Association.

The following shall not be considered to be an affiliate: (i) any company engaged *solely* in holding the premises of the Savings Association; (ii) any company engaged *solely* in conducting a safe deposit business; (iii) any company engaged *solely* in holding obligations of the United States or its agencies or obligations fully guaranteed by the United States or its

³³ 12 C.F.R. §§223.2 and 563.41(b)(1). In referring to the provisions of Regulation W, the term “financial subsidiary” does not apply, as provided in 12 C.F.R. §563.41(b)(2).

³⁴ See the definition of “control” for purposes of transactions with affiliates.

agencies as to principal and interest, and (iv) for a limited time, any company where control results from the exercise of rights arising out of a *bona fide* debt previously contracted. In addition, any company, other than a bank or savings association, that is a subsidiary of the Savings Association shall not be considered an affiliate unless: (i) the subsidiary also is directly controlled by one or more affiliated companies; (ii) the subsidiary also is directly controlled by one or a group of controlling shareholders of the Savings Association; (iii) the subsidiary is an employee stock option plan, trust or similar organization that exists for the benefit of the shareholders, partners, members or employees of the Savings Association or any affiliated company, or (iv) the subsidiary is otherwise determined to be an affiliate by the OTS or the Federal Reserve.

B. Affiliated Company³⁵

The term “affiliated company” means any company of which the Savings Association is a subsidiary or any other subsidiary of that affiliated.

C. Company.³⁶

The term “company” means a corporation, partnership, trust (business or otherwise), association, sole proprietorship, joint venture, unincorporated organization or other business entity. It generally includes financial institutions for purposes of transactions with affiliates (unless specifically excluded) and excludes financial institutions for purposes of loans to insiders.

D. Control.³⁷

For purposes of transactions with affiliates, the term “control” means directly or indirectly, or acting through one or more other persons, the ownership, control or the power to vote 25% or more of any class of voting securities of the Savings Association or any other company. Control also includes being deemed or presumed (without an acceptable rebuttal) to be in control under 12 C.F.R. Part 574, which is, generally, ownership, control or the power to vote 10% of any class of voting securities and requires the combination of the holdings of certain persons, including family members. Control does not include owning or controlling shares in a fiduciary capacity, unless the shares are held by a business trust or are held for the benefit of the controlling shareholders of the Savings Association or affiliated company.

For purposes of loans to insiders, the term “control” means ownership, control or the power to vote 25% or more of any class of voting securities of the Savings Association or any other company, the power to control the election of a majority of directors or the power to exercise a controlling influence over the management or policies of that entity, in each case acting directly or indirectly or in concert with others. A person is presumed, subject to rebuttal, to have control of an entity if he or she (i) is a director or an executive officer of such entity and

³⁵ 12 C.F.R. §215.2(a).

³⁶ 12 C.F.R. §215.2(b). See also 12 CFR §563.41 (b)(6).

³⁷ 12 C.F.R. §215.2(c) and 563.41(b)(6).

directly or indirectly controls or has the power to vote more than 10% of any class of voting securities of the entity, or (ii) directly or indirectly controls or has the power to vote more than 10% of any class of voting securities of the entity and no other person controls or has the power to vote a greater percentage of that class of voting securities.

E. Credit Transaction.³⁸

The term “credit transaction” with an affiliate means an extension of credit to an affiliate, a guarantee issuance or a cross-affiliate netting arrangement.

F. Cross-Affiliate Netting Arrangement³⁹

The term “cross-affiliate netting arrangement” means an arrangement among the Savings Association, one or more of its affiliates and any number of non-affiliates in which:

- § any non-affiliate is permitted to deduct any obligations of the Savings Association’s affiliates when settling obligations owed to the Savings Association, or
- § the Savings Association is permitted or required to add obligations of its affiliates to a non-affiliate when determining obligations owed to the non-affiliate.

G. Eligible Affiliate Activities.⁴⁰

The term “eligible affiliate activities” means activities of an affiliate of the Savings Association that is engaged *solely* in those activities permissible for a bank holding company as described in 12 U.S.C. §1467(c)(2)(F)(i) and 12 C.F.R. §584.2-2. These listed activities consist primarily of:

- § making, acquiring, brokering or servicing loans or other extensions of credit;
- § appraising real estate and personal property;
- § arranging commercial real estate financing as intermediary if the company and its affiliates do not have an interest in managing or developing the real estate and do not promote or sponsor its development;
- § providing check guaranty services;
- § providing collection agency and credit bureau services;

³⁸ 12 C.F.R. §223.3(i).

³⁹ 12 C.F.R. §223.3(j).

⁴⁰ Section 1468(a)(1)(A) of the Home Owners' Loan Act provides that Savings Association may make loans only to an affiliate engaged solely in activities permitted by regulation of the Federal Reserve Board under §4(c)(8) of the Bank Holding Company Act (12 C.F.R. §225.28) unless by regulation the OTS further limits the activities of an affiliate to which a savings association may make loans.

- \$ providing certain asset management, servicing and collection activities for third parties (but not real property management or real estate brokerage);
- \$ acquiring debt in default (within certain restrictions);
- \$ providing real estate settlement services;
- \$ leasing personal or real property as agent, broker or adviser if the lease is nonoperating and has an initial term of at least 90 days and in the case of real estate meets certain other criteria;
- \$ operating an industrial loan company or savings association;
- \$ performing trust company functions;
- \$ acting as an investment advisor or providing securities brokerage services solely as agent for customers, whether or not including investment advisory services (but not including underwriting or dealing), and certain riskless principal, private placement, future commission and other transactional services;
- \$ underwriting and dealing in U.S. governmental securities;
- \$ engaging in foreign exchange and certain futures and swaps transactions, and buying and selling certain precious metals;
- \$ providing management consulting advice to unaffiliated depository institutions (subject to certain interlocks restrictions) and, to a limited extent, to others;
- \$ providing employee benefits consulting services;
- \$ providing career counseling services relating to financial organizations;
- \$ providing courier services for certain documents exchanged among banks;
- \$ providing printing and selling checks and certain related documents;
- \$ underwriting and selling credit insurance on credit extended by the Savings Association and its affiliates, limited to repayment of the balance due in the event of death, disability or involuntary unemployment of the borrower;
- \$ acting as agent or broker for credit insurance on credits issued by a finance company affiliate limited to \$10,000 (or \$25,000 in the case of a manufactured home loan) payable in the event of loss or damage to collateral, and subject to certain other restrictions;
- \$ engaging in certain community development activities including development of housing, services or jobs in loan income areas;
- \$ issuing and selling money orders, savings bonds and traveler's checks, and

§ providing data processing services for financial, banking and economic data, and, to a limited extent, other data processing services.

H. Executive Officer.⁴¹

The term “executive officer” means a person, other than a director, who participates or has the authority to participate in major policymaking functions, whether or not such person has an officer title or receives compensation. The Chairman of the Board, the Chief Executive Officer, the President, any Vice President, the Secretary and the Treasurer of the Savings Association or any affiliated company are deemed to be executive officers, *unless* by resolution of the Board or the bylaws of the Savings Association or the affiliated company, such person is excluded from participating in major policymaking and does not actually participate in any major policymaking functions.

I. Extension of Credit.⁴²

For purposes of transactions with affiliates, the term “extension of credit” means, without limitation, the following:

- § making or renewing any loan;
- § granting a line of credit;
- § an advance by means of an overdraft, cash item, or otherwise;
- § a sale of Fed funds;
- § the acquisition by discount, purchase, exchange or otherwise of any note, commercial paper, debt security, or other obligation of an affiliate;
- § a lease that is the functional equivalent of an extension of credit;
- § any increase in the amount, extension of the maturity or adjustment of the interest rate or other material term of an outstanding extension of credit;
- § any other extending of credit in any matter whatsoever (including on an intraday basis), and
- § any other similar transaction as a result of which an affiliate becomes obligated to pay cash or its equivalent.

For purposes of loans to insiders, the term “extension of credit” means the following:

- § making or renewing any loan;

⁴¹ 12 C.F.R. §215.2(e).

⁴² 12 C.F.R. §§215.3 and 223.3(c).

- \$ granting a line of credit;
- \$ the purchase under a repurchase agreement of securities, assets or obligations;
- \$ an advance by means of an overdraft, cash item or otherwise;
- \$ the issuance of a standby letter of credit (or similar arrangement) or an ineligible acceptance (as defined in 12 C.F.R. §208.24);
- \$ an acquisition by discount, purchase, exchange or otherwise of any note, draft, bill of exchange or other evidence of indebtedness upon which an insider may be liable as maker, drawer, endorser, guarantor or surety;
- \$ an increase of an existing indebtedness (excluding additional funds advanced by the bank for its own protection for accrued interest, taxes, insurance or other incidental expenses);
- \$ an advance of unearned salary or other unearned compensation for an excess of 30 days;
- \$ extending credit in any matter whatsoever, and
- \$ any other similar transaction as a result of which a person becomes obligated to pay cash or its equivalent, directly or indirectly, in any manner whatsoever.

Notwithstanding this definition, extension of credit to an insider specifically excludes:

- \$ any advances against accrued salary or other compensation or for business travel;
- \$ the receipt of a check deposited in or delivered in the usual course of business (unless it results in carrying a cash item or an impermissible overdraft);
- \$ the acquisition of a note, draft, bill of exchange or other evidence of indebtedness in a merger transaction with another depository institution or in a foreclosure on collateral (with a three year limit or OTS approval of an extension);
- \$ an endorsement or guarantee for the protection of an asset acquired by the Savings Association in good faith;
- \$ any indebtedness for the purpose of protecting the Savings Association against loss or providing it financial assistance;
- \$ indebtedness of up to \$15,000 in connection with credit plans or programs described in 12 C.F.R. §225.3(b)(5);
- \$ overdrafts of up to \$5,000 that are otherwise permissible under this Policy;
- \$ any discount of promissory notes, bills of exchange, conditional sales interests or similar paper without recourse;

§ non-interest bearing deposits to the bank's credit, and

§ credits upon uncollected items received in the ordinary course of business.

An extension of credit to an insider is deemed to be made when the Savings Association or affiliate enters into a binding commitment to extend credit. In addition, any extension of credit to a third party is deemed to be an extension of credit to an insider to the extent the proceeds are transferred to an insider or are used for the tangible economic benefit of the insider (unless the third party extension of credit is not on preferential terms and is used in a *bona fide* transaction to acquire property, goods or services from the insider. A participation sold by the Savings Association without recourse is not an extension of credit by the Savings Association.

J. Federally Related Mortgage Loan.

The term "federally related mortgage loan" means any loan secured by a lien on one-to-four-family residential property or any loan to repay such a loan (other than temporary financing such as a construction loan), which is made by an FDIC-insured or federally regulated lender or is otherwise made, insured, guaranteed or assisted in anyway by any officer, agency of the federal government or is intended to be sold to FNMA, FHLMC or GNMA.

K. Guarantee Issuance.⁴³

The term "guarantee issuance" means any issuance of a guarantee, acceptance or letter of credit, including an endorsement or standby letter of credit, on behalf of an affiliate and any confirmation of a letter of credit issued by the affiliate.

L. Immediate Family.⁴⁴

For purposes of the restrictions on loans to insiders, the term "immediate family" means the spouse of an individual, the individual's minor children and any of the individual's children of any age residing in the individual's home.

M. Insider.

The term "insider" means any director, executive officer or principal shareholder and any related interest of such a person.

N. Low-quality Asset.⁴⁵

The term "low-quality asset" means an asset classified as doubtful, substandard or loss, or treated as "special mention" or "other transfer risk problems" in the Savings Association's or affiliate's most recent report of examination or inspection or that is treated as "classified" or

⁴³ 12 C.F.R. §223.3(h)(5).

⁴⁴ 12 C.F.R. §215.2(g).

⁴⁵ 12 C.F.R. §223.3(v).

special mention in the Savings Association's or affiliate's internal classification system; an asset in non-accrual status; an asset as to which payments of principal or interest are more than 30 days past due; an asset whose terms have been renegotiated or compromised due to deteriorating financial condition of the obligor; or an asset acquired through foreclosure, repossession or otherwise in satisfaction of a debt previously contracted, which has not been reviewed in an examination or inspection.

O. Permissible Security

The term "permissible security" means (i) a perfected security interest in obligations of the United States or fully guaranteed as to principal or interest by the United States or an agency of a corporation wholly owned by the United States; (ii) unconditional takeout commitments or guarantees of any department, agency, board or establishment of the United States or corporation owned by the United States; (iii) a perfected security interest in a segregated deposit amount in the Savings Association, or (iv) consumer installment paper acquired from the borrowing insider in accordance with 12 C.F.R. §215.4(d)(3)(i)(D).

P. Principal Shareholder.⁴⁶

The term "principal shareholder" means an individual or company (other than an insured financial institution) that, directly or indirectly, or acting in concert with one or more others, including but not limited to members of an individual's immediate family (as defined above), owns, controls or has the power to vote more than 10% of a class of the voting stock of the Savings Association or of a company that controls the Savings Association. However, a company of which the Savings Association is a subsidiary is not considered a principal shareholder of the Savings Association.

Q. Related Interest.⁴⁷

The term "related interest" means with respect to a person or entity, (i) a company controlled by that person or entity, or (ii) a political or campaign committee that is controlled by that person or company or the funds or services of which will benefit that person or entity.

R. Unimpaired Capital and Surplus⁴⁸

The term "unimpaired capital and surplus" means the aggregate of the Savings Association's Tier 1 and Tier 2 capital plus the balance of its allowance for loan and lease losses not included in Tier 2 capital and the amount of outstanding loans, investments and advances to any subsidiaries not included in calculating Tier 1 capital, based on the most recent Thrift Financial Report filed with the OTS.

⁴⁶ 12 C.F.R. §215.2(m).

⁴⁷ 12 C.F.R. §215.2(n).

⁴⁸ 12 C.F.R. §§563.41(b)(5) and 563.43(f).

XI. Referenced Laws, Regulations and Policies

The following laws and regulations are referred to in this Policy:

A. Federal Laws

- § Section 22(g) of the Federal Reserve Act (Loans to Executive Officers), 12 U.S.C., §375a
- § Section 22(h) of the Federal Reserve Act (Prohibition on Insider Loans), 12 U.S.C. §375b
- § Section 23A of the Federal Reserve (Banking Affiliates), 12 U.S.C. §371c
- § Section 23B of the Federal Reserve Act (Restrictions on Transactions with Affiliates), 12 U.S.C. §371c-1
- § Section 5(q) of the Home Owners' Loan Act (Tying Arrangements), 12 U.S.C. §1464(q)
- § Section 10 of the Home Owners' Loan Act (Regulation of Holding Companies), 12 U.S.C. §1467a
- § Section 11 of the Home Owners' Loan Act (Transactions with Affiliates, Insider Loans), 12 U.S.C. §1468
- § Section 215 of the U.S. Criminal Code (Receipt of Commissions or Gifts for Procuring Loans), 18 U.S.C. §215
- § Section 2608 of the Real Estate Settlement Procedures Act (Title Companies; Liability of Seller), 12 U.S.C. §2608

B. Federal Regulations

- § 12 C.F.R. Part 215 (Regulation O – Insider Loans)
- § Regulation W (Transactions Between Member Banks and Their Affiliates), 12 C.F.R. Part 223
- § 12 C.F.R. §563.41 (Transactions with Affiliates)
- § 12 C.F.R. §563.43 (Loans by Savings Associations to Their Executive Officers, Directors and Principal Shareholders)
- § 12 C.F.R. §563.200 (Conflicts of Interest)
- § 12 C.F.R. §563.201 (Corporate Opportunity)

C. Policies

§ Guidelines for Compliance with the Federal Bank Bribery Law, 52 Fed. Reg. 43941 (1987)

XII. Revisions

At least annually, the Board of Directors of the Savings Association shall review this Policy and revise it if appropriate to conform to current laws and regulations.

Sound Community Bank

Acknowledgment and Agreement

I hereby acknowledge receipt of the Sound Community Bank "Policy on Conflicts of Interest, Transactions with Affiliates and Loans to Insiders," dated 9/19/2006 (the "Policy").

I have read and understand the Policy and agree to be governed by such Policy so long as I serve as a director or officer of Sound Community Bank. I understand that failure to comply with the Policy may result in sanctions as noted in Section IX of the Policy.

Signature

Print Name

Date

Position at Sound Community Bank

[Please sign one copy of this form and provide it to Sara Blake]

Approved September 19, 2006