

(717) 783-8240
www.banking.state.pa.us

June 26, 2002

Dear:

This will respond to your letter and related materials submitted to the Department of Banking (the "Department"), on behalf of [redacted], Lancaster, Pennsylvania (the "Bank"), regarding the Bank's proposal to restructure its Capital through a series of related transactions, which are discussed herein. Specifically, the proposed transaction requests approval or provides notice to the Department for the Bank to: 1) issue a special distribution from its surplus to [redacted] the Bank's parent holding company, of approximately \$44 million, but less than 15% of the Bank's capital; 2) form and become sole common member of [redacted] (the "Subsidiary"), a Delaware limited liability company; 3) issue a subordinated debenture in the form of a subordinated note to the Subsidiary in an amount equal to the aforementioned transfer of surplus to [redacted]; and 4) amend its Articles of Incorporation to authorize the Bank to issue certain preferred stock.

The proposed transaction, which is more fully described in your letter, the attached Bank Parity and Subsidiary Notice, and related schedules, attachments, and exhibits (collectively referred to as "Application Materials"), involves a series of related transactions which in the aggregate achieve the aforementioned capital restructuring of the Bank. The first part of the transaction is the distribution of approximately \$44 million of the Bank's surplus to [redacted]. [redacted] will establish [redacted], a Delaware Corporation (the "Corporation") as a subsidiary and will contribute the \$44 million to the Corporation in exchange for all of the common stock of the Corporation. The Bank will establish the Subsidiary with the Bank owning all of the common voting membership interests and the Corporation owning all of the preferred nonvoting membership interests. The Corporation will contribute the entire \$44 million in exchange for the preferred interests, while the Bank will make a nominal investment in exchange for the common voting membership interests of the Subsidiary. The Bank will have a controlling voting interest in the Subsidiary while the Corporation will have nonvoting preferred interest. The Bank will issue a subordinated debenture to the Subsidiary for the same \$44 million the Bank originally distributed to [redacted]. The Subsidiary will then receive periodic interest payments as mandated and according to the terms and conditions of the subordinated debenture. The Corporation, as the sole preferred interest holder, will receive interest payments from the Subsidiary according to a schedule that coincides with the terms and conditions of the subordinated debenture. The preferred interests in the Subsidiary held by the Corporation will be exchangeable for preferred stock of the Bank under certain mandatory and permissive conditions as detailed in the Application Materials. The proposed transactions (hereinafter collectively referred to as the "Capital Restructuring Proposal"), while altering the composition of the Bank's capital, will not reduce the

overall capital position of the Bank, assuming

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the Federal Deposit Insurance Corporation (“FDIC”) confirms, as discussed below, the Tier One Capital treatment of the preferred interests. The Bank anticipates that the most significant financial impact of the proposed transaction will be a tax benefit to the Bank.

The proposed transactions and the capital restructuring is part of an ongoing effort on the part of the Bank and [redacted] to realize cost savings, achieve greater flexibility in funding and managing the Bank’s assets, and increase retained earnings through prudent tax and business planning. With regard to tax issues of the proposed capital restructuring, this letter does not address tax issues or opine on the tax implication of the proposed business structure. Further, this letter is not binding on the Pennsylvania Department of Revenue or any other Federal or state taxing entity. The Bank, the Subsidiary, [redacted] and the Corporation should contact the Pennsylvania Department of Revenue or the appropriate taxing authority in the State of Delaware, as applicable, to ensure compliance with relevant Pennsylvania and Delaware State tax laws. To clarify, the Department is not requiring that the Bank contact the Pennsylvania Department of Revenue or the Delaware taxing authority, but the Department is suggesting that such contact be made.

The preferred interests issued by the Subsidiary to the Corporation as described above are proposed to become part of the Bank’s consolidated Tier One Capital as Minority Interests in a Consolidated Subsidiary. However, this categorization and the Tier One capital treatment are subject to compliance with applicable Federal capital regulations including 12 C.F.R. Part 325 and Statements of Policy as well as call report instructions, which are administered by the FDIC, and State capital regulations including 10 Pa. Code Chapter 10, which are administered by the Department. The Bank has submitted a letter to the FDIC describing the proposed transaction and requesting confirmation that the resulting preferred interests would be considered Minority Interests in a Consolidated Subsidiary and would qualify as Tier One Capital of the Bank. The treatment of the preferred interests as tier one capital of the Bank by the Department is contingent upon the Bank receiving confirmation of such treatment by the FDIC.

Please be advised that the Department hereby approves the Bank’s Capital Restructuring Proposal, pursuant to various Sections of the Banking Code of 1965 as applicable. This approval is subject to the terms and conditions as detailed below for each component of the overall Capital Restructuring Proposal requiring the Department’s approval or non-objection.

Special Distribution of Surplus

Section 1103(a)(ii) of the Code states that:

An institution shall not by action of the institution reduce surplus without approval of the Department and in no event to an amount less than the amount of capital.

The Department reviewed the Bank’s request, as described above, to distribute \$44 million of surplus to

[redacted]. Based on the current level of capital and surplus, the proposed distribution

will not cause surplus to be less than capital; therefore, the proposed distribution is not explicitly prohibited by the statute. Further, the proposed Capital Restructuring Proposal will cause the decrease in surplus to be offset by an increase in Minority Interests in a Consolidated Subsidiary assuming confirmation by the FDIC. See Treatment of Resulting Capital Structure section below.

Formation of the Subsidiary

Please be advised that the Department does not object to the formation of FB One, LLC, as described above, pursuant to the provisions of Section 203(d) of the Banking Code of 1965, as amended. This non-objection is subject to the following conditions:

1. The activities of the Subsidiary are not to be expanded beyond the purposes as set forth in this letter and any such change will require prior written notice to the Department.
2. The Board of Directors of the Bank and the Subsidiary, respectively, are to establish a limitation on the total amount of borrowings by the Subsidiary from the Bank and any other affiliated companies in compliance with Sections 311(c.1) and 311(e.1) of the Banking Code.
3. The Department will have access to the records of the Subsidiary to the same extent as it has access to the records of the Bank.
4. The Bank and the Subsidiary should contact the Pennsylvania Department of Revenue to ensure compliance with applicable Pennsylvania State tax laws. To clarify, and as previously indicated, the Department is not requiring that Bank contact the Pennsylvania Department of Revenue, but the Department is suggesting that such contact be made.

The following additional conditions are specifically applicable to a subsidiary established in limited liability company form upon initial formation and on an ongoing basis:

1. The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking.
2. The investing Bank must be in a position to prevent the enterprise or entity from engaging in activities that do not meet the foregoing standard.
3. The Bank's loss exposure must be limited, as a legal and accounting matter, and the Bank must not have open-end liability for the obligations of the enterprise.

4. The investment must be convenient or useful to the Bank in carrying out its business and not a mere passive investment unrelated to the business of banking.

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Receipt of the following documentation relative to the formation of the Subsidiary is acknowledged:

1. Identification of the manager and officers of the Subsidiary.
2. A draft copy of the proposed Operating Agreement for the Subsidiary.
3. Copy of the Resolution of the Bank's Board of Directors authorizing formation of the Subsidiary.
4. A draft copy of the proposed Subordinated Debenture.

In order to complete our files in this matter, please forward the following to the attention of Joseph A. Moretz, Manager of Corporate Applications, at the above-noted address:

1. Executed copy of the Operating Agreement for the Subsidiary.
2. Certificate of Organization for the Subsidiary
3. An executed copy of the proposed Subordinated Debenture.
4. A statement setting forth the amount of the Bank's investment in the Subsidiary.
5. The initial balance sheet of the Subsidiary.

Treatment of Resulting Capital Structure

As discussed above, the Bank will be issuing a \$44 million Subordinated Debenture to the Subsidiary. However, for financial accounting purposes and as described in the Application Materials, the debenture will be eliminated in the consolidation of the Bank's financial statements. The debenture will not be disclosed in the Bank's financial statements or in FFC's financial statements other than as a footnote, and will also not be included in quarterly call reports. Therefore, for these and other reasons, the approval of the subordinated debenture as a capital security by the Department pursuant to Section 1105 of the Banking Code is considered unnecessary.

On a consolidated basis, the Bank's proposed capital structure will include the \$44 million of preferred interests, as described above, which the Bank intends to categorize as minority interests in a consolidated subsidiary. Pursuant to Section 315(i) of the Banking Code and 10 PA Code Chapter 10, the Department hereby approves the preferred interests as part of the Bank's capital structure as minority interests in a

consolidated subsidiary for purposes of compliance with the Banking Code. This approval is subject to the Bank receiving written confirmation from the FDIC that the preferred

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interests qualify for Tier One capital treatment pursuant to the aforementioned request letter sent by the Bank to the FDIC. The Bank must submit such an FDIC confirmation letter to the Department.

Articles of Amendment

As previously discussed, the preferred interests to be issued by the Subsidiary to the Corporation are exchangeable for non-cumulative perpetual preferred stock of the Bank under certain mandatory and permissive conditions as detailed in the Application Materials. However, the Bank's Articles of Incorporation do not currently authorize the Bank to issue non-cumulative perpetual preferred stock. Therefore, in order to facilitate the above-described Capital Restructuring Proposal, the Bank is requesting the Department's approval to amend Article Fifth of the Bank's Articles of Incorporation regarding its capital structure. The Department received a draft version of the proposed Articles of Amendment included in the Application Materials.

In order to approve a change in an institution's Articles of Incorporation, Articles of Amendment are filed with the Department in accordance with the provisions of Chapter 15 of the Code.

The Department acknowledges receipt of the following documentation required to effectuate the filing of Articles of Amendment:

1. A letter requesting the Department's approval of such a request.
2. A copy of the Board Resolution authorizing the action.
3. A copy of the Consent of the Sole Shareholder.

In order to complete the filing process, the following documentation must be forwarded to the Department:

1. A check in the amount of \$52.00 made payable to the Pennsylvania Department of State.
2. The original Proofs of Publication made in accordance with the provisions of Sections 109 and 1505 of the Code.
3. The Articles of Amendment, in complete final form, typewritten, in characters not smaller than pica or printed in not less than 10-point type in back or blue-black ink, on one side of 8 ½" x 11" white paper, and providing for a top margin of two (2) inches on the first page and one (1)

inch on all other pages. (Sample enclosed)

Upon receipt of the documentation and its approval, the Department shall have the Articles appropriately filed with the Department of State.

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Approval Requirements

The terms and conditions of the Subordinated Debenture, the Preferred Interest and the Preferred Stock (collectively referred to as the “Financial Instruments”) require the approval of the Department and the FDIC before certain actions can be taken with regard to these Financial Instruments as disclosed in the Application Materials. The overall approval of this Capital Restructuring Proposal is contingent upon the Bank, the Subsidiary, and the Corporation complying with these approval requirements as applicable.

I trust this letter is responsive to your request. Please contact Mr. Moretz should you require additional explanation or information regarding this matter.

Very truly yours,

Richard S. DeMartino
Director - Bureau of
Supervision & Enforcement

RSD:JAM:cam

cc: Daryl P. Stum
Regional Director - FDIC

Joseph A. Moretz
Manager – Corporate Applications

Reginald Evans
Chief Counsel