



March 4, 2009

Office of the Special Inspector General
Troubled Asset Relief Program
ATTN: Neil M. Barofsky
Special Inspector General
1500 Pennsylvania Avenue, N.W., Suite 1064
Washington, D.C., 20220

Dear Mr. Barofsky:

This is in response to your February 6, 2009 letter pertaining to the audit of State Bankshares, Inc. ("State Bank") use of the TARP Funds and compliance with EESA's executive compensation requirements.

In January of this year, State Bank received \$50,000,000 as part of the TARP Program. In response to your question, no attempt was made to segregate these Funds from other funds of State Bank. Our intended use of the Funds is to leverage the additional capital received and continue growing the loan portfolio of State Bank.

Prior to receiving the funds, State Bank was experiencing negative loan growth due to tightening capital restrictions. For the time period of June 30, 2008 to December 31, 2008, State Bank's loan portfolio decreased \$25,905,000 from approximately \$1,728,351,000 to \$1,702,446,000. Enclosed are copies of State Bank & Trust's June 30 and December 31 balance sheet for your review.

Since applying for the TARP Funds, State Bank has taken an active role in educating our communities on the TARP Program and why it makes sense for State Bank to participate in the Program. Enclosed are copies of several of the messages which have been placed in our newspapers discussing the Program.

Also, due to the media coverage of the Program, numerous customers have contacted the bank with questions regarding their accounts and how the TARP Program works. State Bank again has taken an active role in educating and communicating with our customers regarding questions commonly asked about the TARP program. Enclosed is a copy of the Q & A which is located on the homepage of State Bank (which is located as www.statebanks.com). It is also our plan to include the Q & A in each customer's future bank statements.

State Bank is a healthy bank. Our purpose in participating in the TARP Program was to allow us to help stimulate the economy and provide additional loans in the communities we serve. Since receiving the TARP Funds, State Bank has undertaken an active advertising campaign encouraging

small business growth and car refinancing. Enclosed are copies of several of the advertisements which have been placed in the newspapers. The advertisement pertaining to car loans is also included on the homepage of State Bank.

Due to the TARP Funds, State Bank is now in a growth mode. From December of 2008 to the end of January 2009, State Bank experienced loan growth of \$39,610,000, increasing the loan portfolio from approximately \$1,702,446,000 to \$1,742,056,000. (b) (4)

(b) (4) Enclosed is a copy of State Bank & Trust's January 31 balance sheet for your review.

As part of the TARP application and process, we are aware of and have reviewed the restrictions on executive compensation that pertain to the TARP Funding. State Bank is within all limits of executive compensation and will remain within the compensation restrictions in the future. Because of the compliance with the restrictions, no changes are needed to our executive compensation structure.

It is State Bank's plan to continue the active marketing for additional loans to assist in stimulating the economy. This marketing effort will consist of additional newspaper advertising and marketing to our existing customer base. We believe with this effort, our loan portfolio will continue to increase and we will utilize the TARP Funds for the proper purpose for which they were distributed.

We also understand that the current provisions of the TARP Program can be changed by Congress. It appears from recent news segments that Congress for some reason wants to make this Program more difficult and demanding for banks to administer and that several have considered returning the TARP Funds due to these demands. We know that State Bank can and will use the funds for the intended purposes. Hopefully, Congress will not over govern this Program to the point of making it undesirable for the intended purpose.

If any additional information is needed, please contact me.

Sincerely,



Rodney C. Jordahl,
Executive Vice President and COO
State Bank & Trust

STATEMENT OF CERTIFICATION

I, Rodney C. Jordahl, am a duly authorized senior executive of State Bank & Trust. By signing below, I hereby certify the accuracy of all statements, representations and supporting information contained in this letter, subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001.


Rodney C. Jordahl

**State Bank & Trust
Balance Sheet**

	June 30, 2008	December 31, 2008	January 31, 2009
Total Cash & Due From Banks	\$53,041,110	\$77,320,759	\$36,914,870
Fed Funds Sold	0	8,900,000	14,650,000
Available for Sale Securities	89,073,525	105,905,577	88,802,956
Held to Maturity Securities	905,250	1,188,250	1,188,250
Federal Home Loan Stock	10,251,400	6,901,600	6,901,600
Total Investments	\$100,230,175	\$122,895,427	\$111,542,806
Total Consumer Loans	337,663,705	340,231,771	334,977,216
Commercial Loans	1,266,256,111	1,230,861,694	1,282,853,753
AG Loans	123,137,398	130,604,219	123,743,959
Overdrafts	1,294,305	748,941	481,763
Total Lns Net of Alloc Res	\$1,728,351,518	\$1,702,446,625	\$1,742,056,690
Loan Loss Reserves	16,412,101	20,760,424	21,712,259
Total Loans Net of Reserves	\$1,711,939,417	\$1,681,686,201	\$1,720,344,432
Net Buildings & Equipment	20,116,103	19,399,704	19,103,127
Total Other Assets	21,955,546	26,374,165	26,186,671
Total Assets	\$1,907,282,351	\$1,927,676,256	\$1,914,091,906
Non-Interest Deposits	203,598,509	233,369,829	231,841,314
Interest Checking	146,529,797	162,918,770	155,849,745
Regular Savings	11,403,055	12,651,542	12,994,049
Money Market Savings	408,305,465	408,012,164	416,304,278
Brokered MM	28,304,762	91,006,516	91,010,377
Certificate Of Deposit	626,657,502	656,758,981	666,777,292
Brokered Certificate of Deposit	75,473,000	15,000,000	5,000,000
Total Deposits	\$1,500,272,089	\$1,579,717,801	\$1,579,777,055
Fed Funds Purchased	4,650,000	0	0
Repurchase Agreements	35,332,634	51,384,862	40,250,912
FHLB ST Advances	69,950,000	0	0
FHLB LT Advances	105,000,000	105,000,000	105,000,000
Total Other Liabilities	21,520,065	16,863,502	13,377,226
Total Liabilities	\$1,736,724,789	\$1,752,966,165	\$1,738,405,194
Common Stock	600,000	600,000	600,000
Paid in Capital	74,772,701	74,772,701	74,772,701
Retained Earnings	87,741,596	87,741,596	97,575,818
Current Year Income	6,665,600	9,834,222	1,102,133
Comprehensive Income AFS Sec	777,665	1,761,572	1,636,059
Total Equity	\$170,557,562	\$174,710,091	\$175,686,712
Total Liabilities & Equity	\$1,907,282,351	\$1,927,676,256	\$1,914,091,906

Local, Community Banks: Money to Lend, Now & in the Future

This past week, national news outlets seemed to be trumpeting fears that banks would freeze credit lines and stop making loans. As a local banker, I want to reassure you that those fears are unwarranted in our region because of our strong local economy and the financial stability of our banks.

Your local, community banks, which have stayed away from subprime loans and subprime-backed investments, should not be painted with the same broad brush as the Wall Street investment banks. A consistent, conservative lending approach in our stable regional economy has prevented area banks from feeling the same effects as the national and international financial giants.

State Bank & Trust and other local, community banks continue to have money to lend. We are lending money every day for many purposes, including:

- Home mortgage & construction loans for qualified home buyers
- Commercial loans & lines of credit for businesses of all sizes
- Agricultural loans for farmers & agribusinesses
- Personal loans & lines of credit to finance cars, boats, RVs, home remodeling projects and more

Community banks in our region are well capitalized and financially sound. Rather than freezing credit lines, your local banks are lending money to individuals and businesses every day, and we'll continue to do so in the future. Remember—that's confidence you can bank on.

Sincerely,



Richard H. Solberg, President & CEO
— State Bank & Trust



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Treasury's Capital Purchase Program Will Stimulate the U.S. Economy

Like most taxpayers, I am against any "bank bailout" program if the money is used to purchase bad loans from banks and securities firms that did not make prudent lending decisions. Banks that made bad loans should face the consequences and absorb the losses.

Now, however, the Treasury Department is changing its approach and is focusing on providing an economic stimulus to Main Street through a "Capital Purchase Program," available only to healthy commercial banks across the country.

Larger national banks such as Wells Fargo and U.S. Bank have already participated in the program. Now, smaller, privately held banks like ours are encouraged to take part. Unless circumstances or the terms of the program substantially change, State Bank & Trust plans to participate in the Capital Purchase Program, and you will see many other healthy North Dakota and regional banks do the same.

Here's how it works. Participating banks will issue preferred stock—in State Bank & Trust's case, between 1% and 3% of our qualified assets, totaling from \$18 million to \$54 million—to the U.S. Treasury. The Treasury will receive a minimum dividend of 5% and in addition, will receive stock warrants, making this a profitable investment for our government. This program also does not allow exorbitant bonuses or "golden parachutes" for executives, and that's good policy.

Every Capital Purchase Program dollar invested by the Treasury gives banks the opportunity to generate up to ten times that amount in loans. This means that our local banks can make more home loans, car loans and small business loans to qualified borrowers in our communities, spurring the economic growth of our region.

Local community banks will play an important role in the nation's economic recovery. That's good for all of us—and that's confidence you can bank on.

Sincerely,



Richard H. Solberg, President & CEO
— State Bank & Trust



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Local Banks Will Play Key Role in Economic Recovery

You may have heard that banks across the country have tightened or even frozen credit, making it difficult for people to buy a home or for small businesses to obtain needed capital. This is not the case locally, as our community banks are making loans to qualified buyers and businesses, just as we always have.

State Bank & Trust's assets grew by more than \$100 million in 2008, and like other local banks, we plan to continue this strong asset and loan growth in 2009 and beyond. We know that growing community banks will play a key role in helping to spur our country's economic recovery.

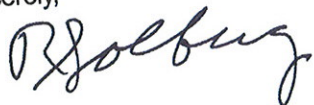
To give banks greater opportunities to stimulate economic growth, the U.S. Treasury is encouraging healthy banks to take part in the government's Capital Purchase Program. Many North Dakota and regional banks, including State Bank & Trust, will be participating in the government's effort to inject additional capital into the banking system and stimulate the economy.

There are many misconceptions about this Capital Purchase Program. Briefly, here's how it works:

- This money is not a gift or a "bailout," but a federal government loan to healthy banks in the form of a preferred stock investment.
- The government (and U.S. taxpayers) will make money with this program. We intend to pay back the government's capital investment, with 5% interest, in three to five years.
- Banks benefit, because they can use the additional capital to increase both deposits and loans.

Many banks will be participating in the Capital Purchase Program, and others will not. But the bottom line is that our local community banks will be working together to help people buy homes and cars, help farmers and small businesses succeed and employ more people, and help the economy and our region to grow and prosper.

Sincerely,



Richard H. Solberg, Chairman & CEO
— State Bank & Trust



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Q&A: U.S. Treasury Capital Purchase Program (TARP)

We have received some questions from our customers and others about the U.S. Treasury's Capital Purchase Program, a widely misunderstood component of the "TARP" funding approved by Congress. We hope the following "Q&A" gives you a better understanding of the government's efforts to use this program to stimulate the economy.

Q. Why would State Bank & Trust, or any other healthy bank, participate in this program?

A. State Bank & Trust and other healthy banks were encouraged by the U.S. Treasury to participate as part of the government's effort to inject new capital into the banking system and stimulate lending in communities all around the country. We believe this program will be beneficial to our communities and a profitable program for our bank.

In today's economy, traditional sources of the capital that banks need have either been "frozen" or are too expensive to provide a reasonable return. While the Capital Purchase Program falls under the umbrella of the TARP funding package, they are two distinct programs. Many consider TARP a "bailout" of financial institutions with troubled assets (such as "subprime" mortgages). The Capital Purchase Program money, however, is a federal government loan in the form of a preferred stock investment. It was designed to give a needed source of new capital to banks like ours that wish to continue to grow and meet their customers' credit needs. The government (and U.S. taxpayers) will be paid back in full, with a 5% dividend each year. We intend to pay back the government's stock investment in three to five years.

Q. If you are paying the government 5% on the money you received, why won't you pay depositors 5% on their CDs?

A. Capital Purchase Program funds and customer deposits are different from each other. Capital Purchase Program money is not a deposit in our bank, but counts as capital used to support our loan growth. This loan in the form of preferred stock has a fixed rate of 5% for five years—a fair rate for a loan in today's economy.

Rates on FDIC-insured deposits such as CDs, on the other hand, tend to follow bond market interest rates, which fluctuate with the economy and are currently at record lows. Hopefully, our economy will improve, and deposit rates will rise soon.

Q. If you're paying the government back with 5% interest, won't you have to charge your customers higher rates on their loans to make it work?

A. No. Bank interest rates, like deposit rates, tend to fluctuate with the market. When deposit rates are low, loan rates tend to be lower, and both are higher in an "up" economy. Our loan interest rates are not related to the interest we will pay on our Capital Purchase Program funds.

Ten cents of every dollar that we lend has to be backed by "capital." The other 90 cents of each dollar will be funded with new deposits. The government's investment of \$50 million through the Capital Purchase Program is considered capital for State Bank & Trust under banking regulations. In the coming years, this capital will give us the ability to provide up to \$500 million in new loans and allow us to grow our deposit base by \$450 million—growth that we could not have achieved without it.

Q. Why is this program good for the economy?

A. Our new loans will help small businesses and farmers—the "engines" that drive our region's economy—grow and prosper. When they succeed, they expand their operations, buy more equipment, sell more products and services, and create more jobs. New loans will also help people buy homes and cars, as well as refinance houses and cars to reduce their monthly payments.

We know that growing community banks like ours have a key role to play in helping to spur our country's economic recovery. Our goal is for State Bank & Trust to be a successful "model" of how the Capital Purchase Program was intended to work in stimulating economic growth in our own communities and across the country.



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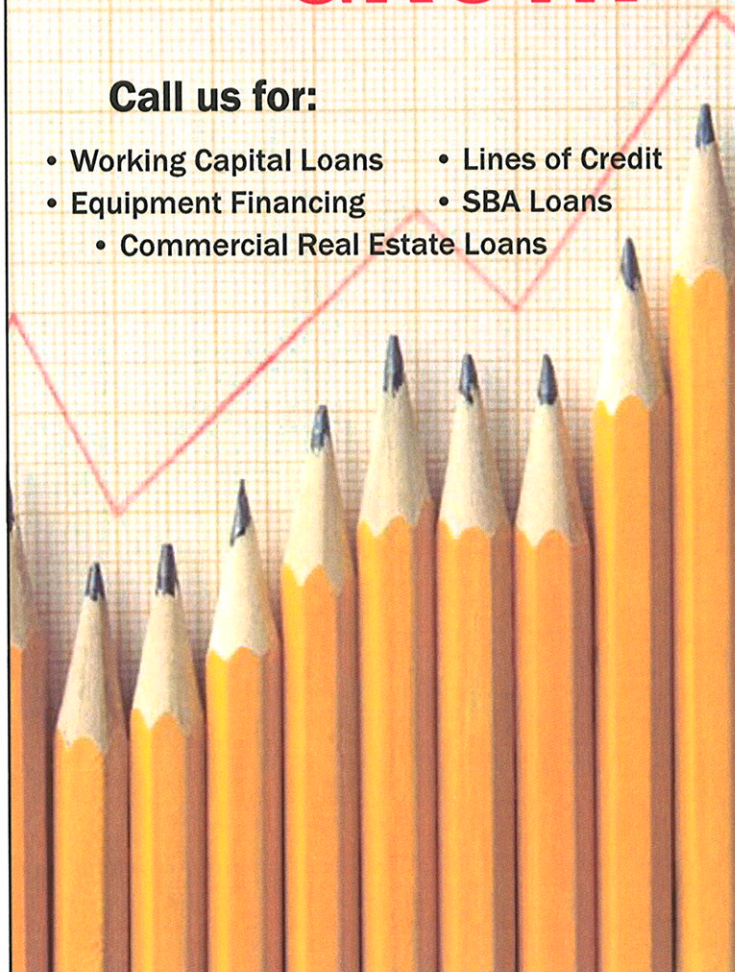
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