LSB Corporation

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March 2, 2009

Neil M. Barofsky, Special Inspector General – TARP
1500 Pennsylvania Avenue, N.W., Suite 1064
Washington, DC 20220

Dear Special Inspector General Barofsky:

In response to your letter of February 6, 2009, and in the order of your letter, LSB Corporation submits the following:

1A. Background – Anticipated Use. When the TARP program was first announced, our initial reaction was not to participate. LSB Corporation and its subsidiary bank, River Bank, met all the regulatory requirements for classification as "well-capitalized" as that term is defined by federal bank regulatory agencies. River Bank's assets are sound and the loan portfolio was experiencing and continues to experience minimal delinquency. The Bank enjoys an overall regulatory rating of "2".

Independent of TARP, River Bank had been experiencing an increase in credit-worthy, local loan demand. Both the absence of conduit lenders and the retreat from local lending by large, multinational competitors increased the demand of borrowers looking to refinance maturing loans presently held by reluctant lenders.

Shortly after the enactment of TARP, public discourse considered that all eligible, (i.e., well-capitalized, highly rated) banks should apply for TARP funding so as to increase the availability of capital to support more lending. Given the public perception that strong banks should step up to do their part to improve the economy and given our own belief that we should do as much as possible to support our local economy and given the increased local loan demand, the Boards of LSB Corporation and River Bank voted to apply for the full allotment of TARP funds.

Throughout the deliberations on whether to apply for TARP funds, the Board and management of LSB Corporation were clear that the sole purpose of the funds would be as regulatory capital to be levered approximately 10 to 1 to support $150 million of additional loans, both retail and commercial. The $15 million of TARP funding was applied for and accepted for the sole purpose of increasing loan activity and loan balances.

LSB Corporation received $15 million of TARP funds on December 12, 2008. Since that time, somehow the public perception of TARP funding has completely changed and recipients are now viewed as failed banks surviving solely on the largesse of the taxpayer. In that same vein, provisions of the "Stimulus legislation" ("ARRA") can be viewed only as punitive to all TARP recipients. Consequently, actions that LSB Corporation thought were public spirited and in the best interests of our local community have been twisted into an extreme negative, detrimental to the LSB Corporation and its shareholders. As a result, LSB Corporation is reviewing the ARRA provisions which allow the repayment of TARP funds. LSB Corporation is most desirous of as rapid a withdrawal from the TARP program as possible. The resulting reduction in our lending activity will be a necessary if unfortunate consequence of early repayment.

1B. TARP funds were not segregated.

1C. Immediately upon receipt, TARP funds were used to purchase short-term, conservative, highly liquid investments with the expectation that those investments would be liquidated as additional loans were booked. To date, the loan portfolio of LSB Corporation has increased by $15 million since the receipt of the $15 million of TARP funding.

1D. LSB Corporation intends to use all the TARP funds as funding for additional loans and had intended to further leverage that regulatory capital by a factor of 10 to 1 for an additional $150 million of loans. Given LSB Corporation's consideration of exiting the TARP program and repaying the full $15 million, that leverage will not occur.

LSB Corporation's original intent to lever the $15 million of TARP funds into $150 million of new loans would not be possible without TARP. Given the changed perception, both in the general media and the U. S. Congress that TARP funding has been used exclusively for the bailout of failed banks, LSB Corporation is exploring an early exit from the program.

2. LSB Corporation will abide by the compensation provisions and limitations enacted in "ARRA" which we assume supercede all prior U.S. Treasury regulations. Accordingly, LSB Corporation asserts the follows:

- LSB Corporation will prohibit compensation that provides incentives for senior executive officers to take unnecessary and excessive risks that threaten the value of the institution.
- LSB Corporation will adopt claw-back provisions to recover any bonus, retention award or incentive compensation paid to the senior executive officers and any of the next 20 most highly-compensated employees based on statements of earnings, revenues, gains or other criteria that are later found to be materially inaccurate.

- LSB Corporation's officers and the next five most highly-compensated employees are prohibited from receiving any payment upon severance from employment.
- LSB Corporation will not have compensation plans that encourage manipulation of the reported earnings in order to enhance the compensation of any of its employees.
- LSB corporation will not pay or accrue to Gerald Mulligan, President and Chief Executive Officer, any bonus, retention award or incentive compensation, other than the payment of restricted stock that (i) does not fully vest during the period in which there is any outstanding obligation arising from financial assistance provided under the TARP, (ii) has a value no greater than one-third of the employee's annual compensation and (iii) is subject to any other terms and conditions the Secretary of the Treasury determines.

Lastly, the LSB Corporation further represents:

- LSB Corporation owns no vehicles of any sort: planes, boats, cars or trucks.
- No officer at the level of Senior Vice President and above has any loan outstanding with the Bank and all are prohibited from such borrowings.

Very truly yours,

Gerald T. Mulligan
President and
Chief Executive Officer

Attachments:

A. Schedule of loan balances as of December 12, 2008 and January 31, 2009.
B. Newspaper articles expressing LSB Corporation's intended use of TARP funds for increased lending.

LSB Corporation
Capital Purchase Program
Balance Sheet Tracking

		12-Dec-2008	31-Dec-2008	31-Jan-2009
	Retail Loans	$ 133,635	$ 134,079	$ 142,090
	Corporate Loans	$ 318,081	$ 318,542	$ 324,447
	Total Loans	$ 451,716	$ 452,621	$ 466,537
A	**Net Change Loans**	**$ -**	**$ 905**	**$ 13,916**
	Accumulated Net Change Loans			***$ 14,821***
	Investment Securities	$ 246,995	$ 264,561	$ 265,537
B	**Net Change Investments**	**$ -**	**$ 17,566**	**$ 976**
	Accumulated Net Change Invest.			***$ 18,542***

Summary:

Combined Net Change - Monthly	**$ 18,471**	**$ 14,892**
Accumulated Net Growth From 12/12/08		**$ 33,363**

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Financial institutions set to unlock funds

The Boston Globe

How much in new lending to homeowners, firms will result from the federal infusion?

By Ross Kerber and Michael Kranish, Globe Staff | January 16, 2009

The nine Massachusetts banks that collectively received $2.3 billion from the federal bailout are poised to launch new loan programs to put money into the hands of homeowners and businesses.

One caveat: It's too soon to know exactly how much new lending will come of these efforts.

The local banks were among the 257 institutions that so far have received a total of $192 billion from the Treasury under an extraordinary program begun last fall to bolster lenders' capital and jump-start the economy. Federal officials hoped the banks would use the money to increase lending, but they did not impose such requirements in the program, part of what is known as the Troubled Asset Relief Program.

The lack of rules has led to complaints the banks aren't using the money effectively. But the local banks said they are now doing exactly what the government wants.

At Leader Bancorp in Arlington, which received $5.8 million, chief executive Sushil K. Tuli said the federal money is funding loans for first-time home buyers and mortgages to help homeowners refinance. "The capital allowed us to grow the bank more. We were maxed out" before the infusion, Tuli said.

Independent Bank Corp., parent of Rockland Trust, is planning to use the $78 million it just received to expand a program to assist first-time home buyers, put a 60-day moratorium on foreclosure proceedings, and increase residential and commercial lending.

"This capital is part of the funding source that will fuel that growth," said Ralph R. Valente, Rockland senior vice president.

One challenge for the banks is increasing lending during a recession, when there are fewer quality borrowers and less demand for loans. Robert Patrick Cooper, senior counsel of OneUnited Bank in Boston, which received $12 million, cautioned the recession will make it tougher to fulfill its pledge to increase lending.

"It's difficult to put an absolute number on the amount of lending, due to the uncertainty in the marketplace," he said.

One recipient said it is having no trouble finding borrowers, likely including companies that have been turned down for loans by larger banks. Gerald T. Mulligan, the chief executive of LSB Corp., the parent of River Bank in North Andover, said he is using some of the $15 million the bank received from the government to fund these new loans.

Several recipients that are publicly traded said they were unable to provide much detail about their use of the federal funds because they are in a so-called quiet period before the release of quarterly earnings. One is State Street Corp., which received the largest allotment in Massachusetts, $2 billion, and reports earnings Tuesday.

In a statement, a State Street spokeswoman said it is using the money "to expand the flow of credit" to customers such as pension funds, and mutual funds, in some cases replacing other credit sources that are no longer available. State Street is not a traditional bank, but rather a provider of services to the financial system, such as accounting, custodial, and trade processing.

Meanwhile, Berkshire Hills Bancorp of Pittsfield won't say what it is doing with the $40 million it received a month ago. When asked, spokeswoman Fedelina Madrid said the bank would "defer comment until we have some impact from our dollars."

That lack of information underscores complaints about this portion of the federal bailout, in which the Treasury buys preferred shares in the banks and in turn receives a low 5 percent interest rate. The dividend increases to 9 percent after five years as an incentive for banks to repay the money.

The terms contrast with a bank rescue plan enacted in England at the same time. There, British authorities required the Royal Bank of Scotland, the parent of US-based Citizens Bank, to replace its chief executive, commit to keep lending at past levels, and install new board members.

In the United States, critics have seized on the absence of information to question whether banks are sitting on the money. Even those banks that are forthcoming cannot put a dollar figure on how much new lending they will do. These missing details have prompted Congress to impose more requirements and accountability on the second round of bailout funds, $350 billion, that the Senate voted to release to the Treasury Department yesterday.

Even without the requirements, some contend the banks have an obligation to tell taxpayers what they are doing with their money.

"If a bank or anyone else wants to take billions in taxpayer dollars, then that bank owes some basic explanations about how that money will be used," said Elizabeth Warren, a Harvard Law School professor who chairs a congressional oversight panel on the $700 billion package.

The banks, meanwhile, contend they are using the funds to support the program's goal of stabilizing the economy.

"I see TARP doing exactly what it's intended to do, to increase lending and liquidity in the system, but it will be hard to get a perfect report that measures the impact," said David Kaye, chief financial officer of Boston Private Financial Holdings, which received $154 million. The company expects new loans financed with the federal funds will help offset a drop-off in overall lending in 2009 because of the recession.

At Wainwright Bank & Trust Co. in Boston, which received $22 million, chief financial officer James Barrett said it will use the money to continue to make loans while remaining well-capitalized.

Executives at another recipient, Central Bank of Somerville, did not return several messages requesting information on their plans for the $10 million the bank received. But in newspaper advertisements yesterday the bank declared: "We have money to lend."

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