

SUPERVISORY AGREEMENT

This Supervisory Agreement (Agreement) is made this 10th day of November, 2010 (Effective Date) by and through the Board of Directors (Board) of Middlesex Federal Savings, F.A., Somerville, Massachusetts, OTS Docket No. 01452 (Association) and the Office of Thrift Supervision (OTS), acting by and through its Regional Director for the Northeast Region (Regional Director);

WHEREAS, the OTS, pursuant to 12 U.S.C. § 1818, has the statutory authority to enter into and enforce supervisory agreements to ensure the establishment and maintenance of appropriate safeguards in the operation of the entities it regulates; and

WHEREAS, the Association is subject to examination, regulation and supervision by the OTS; and

WHEREAS, based on its examination of the Association, the OTS finds that the Association has engaged in unsafe or unsound practices and/or violations of law or regulation; and

WHEREAS, in furtherance of their common goal to ensure that the Association addresses the unsafe or unsound practices and/or violations of law or regulation identified by the OTS in the March 29, 2010 Report of Examination (2010 ROE), the Association and the OTS have mutually agreed to enter into this Agreement; and

WHEREAS, on November 3, 2010, the Association's Board, at a duly constituted meeting, adopted a resolution (Board Resolution) that authorizes the Association to enter into this Agreement and directs compliance by the Association and its directors, officers, employees, and other institution-affiliated parties with each and every provision of this Agreement.

NOW THEREFORE, in consideration of the above premises, it is agreed as follows:

Business Plan.

1. Within thirty (30) days, the Association shall submit an updated comprehensive business plan for the period of January 1, 2011 to December 31, 2013 (Business Plan) to ensure that it addresses all corrective actions in the 2010 ROE relating to the Association's Business Plan. At a minimum, the Business Plan shall conform to applicable laws, regulations and regulatory guidance and include:

- (a) plans to improve the Association's core earnings and achieve profitability on a consistent basis throughout the term of the Business Plan;
- (b) strategies for ensuring that the Association has the financial and personnel resources necessary to implement and adhere to the Business Plan and comply with this Agreement;
- (c) plans to ensure maintenance of sufficient regulatory capital for the Association's risk profile given the Association's problem assets and higher risk loan concentrations;
- (d) plans to ensure compliance with all requirements of this Agreement;
- (e) quarterly pro forma financial projections (balance sheet, regulatory capital ratios, and income statement) for each quarter covered by the Business Plan that are presented in a format consistent with the Thrift Financial Report (TFR); and
- (f) identification of all relevant assumptions made in formulating the Business Plan and a requirement that documentation supporting such assumptions be retained by the Association.

2. Upon receipt of written notification from the Regional Director¹ that the Business Plan is acceptable, the Association shall implement and adhere to the Business Plan. A copy of the Business Plan and the Board meeting minutes reflecting the Board's adoption thereof shall be provided to the Regional Director within ten (10) days after adoption of the Business Plan by the Board.

3. Any material modifications² to the Business Plan must receive the prior written non-objection of the Regional Director. The Association shall submit proposed material modifications to the Regional Director at least forty-five (45) days prior to implementation.

4. Within thirty (30) days after the end of each quarter, after implementation of the Business Plan, the Board shall review quarterly variance reports on the Association's compliance with the Business Plan (Business Plan Variance Reports). The Business Plan Variance Reports shall:

- (a) identify variances in the Association's actual performance during the preceding quarter as compared to the projections set forth in the Business Plan;
- (b) contain an analysis and explanation of identified variances; and
- (c) discuss the specific measures taken or to be taken to address identified variances.

5. A copy of the Business Plan Variance Reports and Board meeting minutes shall be provided to the Regional Director within ten (10) days after the Board meeting.

Higher Risk Loan Concentrations of Credit.

6. Within sixty (60) days, the Association shall develop and implement a written program for identifying, monitoring, and controlling risks associated with concentrations of higher risk

¹ References to the "Regional Director" shall include his authorized designee.

² A modification shall be considered material under this Section of the Order if the Association plans to: (a) engage in any activity that is inconsistent with the Business Plan; or (b) exceed the level of any activity contemplated in the Business Plan or fail to meet target amounts established in the Business Plan by more than ten percent (10%), unless the activity involves assets risk-weighted fifty percent (50%) or less, in which case a variance of more than twenty-five percent (25%) shall be deemed to be a material modification.

loans³ (HRL Credit Concentration Program) to ensure that it is acceptable to the Regional Director and addresses all corrective actions set forth in the 2010 ROE relating to HRL concentrations of credits. The HRL Credit Concentration Program shall comply with all applicable laws, regulations and regulatory guidance and shall:

- (a) establish comprehensive concentration limits of no higher than three hundred percent (300%) of Tier 1 (Core) Capital plus allowance for loan and lease losses (ALLL), and document the appropriateness of such limits based on the Association's risk profile;
- (b) contain specific review procedures and reporting requirements, including written reports to the Board, designed to identify, monitor, and control the risks associated with concentrations of HRL credits; and
- (c) establish a written action plan, including specific time frames, for bringing the Association into compliance with its HRL concentration of credit limits.

7. The Board's review of the HRL Concentration Program shall be documented in the Board meeting minutes. A copy of the HRL Credit Concentration Program shall be provided to the Regional Director within ten (10) days of adoption by the Board.

8. Within thirty (30) days after the end of each quarter, beginning with the quarter ending December 31, 2010, the Board shall review the appropriateness of the Association's concentration limits given current conditions and the Association's compliance with its HRL Credit Concentration Program, including the written action plan to reduce the current level of concentrations. The Board's review of the Association's HRL Credit Concentration Program shall be documented in the Board meeting minutes.

³ For purposes of this Agreement, the term "higher risk loans" (HRL) is defined as gross construction loans, construction loans-in-process, multi-family loans, land loans, non-residential real estate loans, and commercial loans.

Problem Assets.

9. Within sixty (60) days, the Association shall submit a detailed, written plan with specific strategies, targets and timeframes to reduce⁴ the Association's level of problem assets⁵ (Risk Reduction Plan) to the Regional Director. The Risk Reduction Plan, at a minimum, shall include:

- (a) quarterly targets for the level of problem assets as a percentage of Tier 1 (Core) capital plus ALLL; and
- (b) a description of the methods for reducing the Association's level of problem assets to the established targets.

10. The Board's review of the Risk Reduction Plan shall be documented in the Board meeting minutes. A copy of the Risk Reduction Plan shall be provided to the Regional Director within ten (10) days of adoption by the Board.

11. Within sixty (60) days, the Association shall develop individual written specific workout plans for each problem asset or group of loans to any one borrower or loan relationship of five hundred thousand dollars (\$500,000) or greater (Asset Workout Plans).

12. Within sixty (60) days after the end of each quarter, beginning with the quarter ending December 31, 2010, the Association shall submit a quarterly written asset status report (Quarterly Asset Report) to the Board and the Regional Director. The Board's review of the Quarterly Asset Report shall be documented in the Board meeting minutes. The Quarterly Asset Report shall include, at a minimum:

- (a) the current status of all Asset Workout Plans;

⁴ For purposes of this Paragraph, "reduce" means to collect, sell, charge off, or improve the quality of an asset sufficient to warrant its removal from adverse criticism or classification.

⁵ The term "problem assets" shall include all classified assets, assets designated special mention, and real estate owned.

- (b) a comparison of problem assets to Tier 1 (Core) capital plus ALLL and Total Risk-Based capital;
- (c) a comparison of problem assets at the current quarter end with the preceding quarter;
- (d) a breakdown of problem assets by type and risk factor, including, but not limited to, residential, acquisition and development, construction, land loans, location and origination source;
- (e) an assessment of the Association's compliance with the Risk Reduction Plan;
- (f) a discussion of the actions taken during the preceding quarter to reduce the Association's level of problem assets; and
- (g) any recommended revisions or updates to the Risk Reduction Plan.

Loan Department Structure and Staffing.

13. Within thirty (30) days, the Association shall develop and implement a plan to ensure that the structure and staffing of the lending and workout departments are adequate to support effective loan workout, loan collection, and internal loan review functions at the Association (Loan Department Plan). The Loan Department Plan shall address all recommended corrective actions set forth in the 2010 ROE relating to the loan department structure and staffing, and, at a minimum, shall:

- (a) require the Senior Lending Officer (SLO) to have clear authority to manage the lending and workout departments of the Association;
- (b) require the officers and employees involved with oversight of the HRL portfolio to have clear authorities and lines of reporting to the SLO, and to have adequate experience, training and expertise in loan review and workout;

- (c) establish a loan department structure that is adequately staffed to address the size, complexity, growth, and composition of the HRL portfolio, and segregates the administration of the residential mortgage portfolio from the HRL portfolio; and
- (d) require the addition of a qualified Credit Officer and additional loan workout and collection officers and employees sufficient to adequately support effective loan workout, loan collection, and internal loan review functions at the Association.

14. A copy of the Loan Department Plan and the Board meeting minutes reflecting the Board's adoption thereof shall be provided to the Regional Director within ten (10) days after adoption of the Loan Department Plan by the Board.

Allowance for Loan and Lease Losses.

15. Within thirty (30) days, the Association shall revise and implement policies, procedures, and methodology relating to the timely establishment and maintenance of an adequate ALLL (ALLL Policy) to ensure that it is acceptable to the Regional Director and addresses all corrective actions set forth in the 2010 ROE relating to ALLL. The ALLL Policy shall comply with applicable laws, regulations, and regulatory guidance and shall:

- (a) incorporate the results of all internal loan reviews and classifications;
- (b) address the historical loan loss rates of the Association in compliance with regulatory guidance;
- (c) include the appropriate use of Financial Accounting Standards Board (FASB) 114 impairment analysis; and
- (d) implement any recommendations from the external auditors regarding the Association's ALLL methodology.

16. Within thirty (30) days after the end of each quarter, beginning with the quarter ending December 31, 2010, the Association shall analyze the adequacy of the ALLL consistent with its ALLL Policy (Quarterly ALLL Report). The Board's review of the Quarterly ALLL Report, including, but not limited to, all qualitative factors considered in determining the adequacy of the Association's ALLL, shall be fully documented in the Board meeting minutes. Any deficiency in the ALLL shall be remedied by the Association in the quarter in which it is discovered and before the Association files its TFR with the OTS.

Restrictions on Lending.

17. Effective immediately, the Association shall not make, invest in, or purchase any new HRL.

18. Effective immediately, the Association shall not refinance, extend, or otherwise modify, any existing HRL to any borrower unless: (a) the Association has obtained and verified updated financials and current valuations; (b) the Board has provided prior approval of the particular HRL renewal or modification; and (c) for any HRL that is classified or criticized, any renewal or modification must be supported by a workout plan.

Credit Administration.

19. Within sixty (60) days, the Association shall develop and implement credit administration policies, procedures, practices, and controls (Credit Administration Policy) that is acceptable to the Regional Director and addresses all corrective actions in the 2010 ROE relating to credit administration. The Credit Administration Policy shall comply with all applicable laws, regulations and regulatory guidance and:

- (a) include polices, procedures, and systems to obtain and analyze, on at least an annual basis, updated borrower financial information on any HRL;

- (b) include guidelines requiring that current financial statements from the borrower and/or guarantor be provided to the Association prior to loans being modified, extended or refinanced and that such financial statements be reviewed to determine whether the borrower and/or guarantor has the ability to repay at the modified loan terms;
- (c) include an effective system for the retention, review, renewal, and updating by the Association of all required records, filings, and other credit related documents, including a detailed system of recording contacts with borrowers, project status reports, and commentary;
- (d) include funding controls over costs on construction projects to prevent disbursements of loan funds in excess of completed construction costs;
- (e) require interim financial statements for any loans where annual financial statements are delayed and/or are not available; and
- (f) expand the monitoring of the Association's speculative construction loan portfolio to provide a review and report of the current status of speculative construction loan projects, including a comparison of current sales volume, rental activity, and unit pricing information to that forecasted at the time of the original loan approval.

20. The Board's review of the Credit Administration Policy shall be documented in the Board meeting minutes. A copy of the Credit Administration Policy shall be provided to the Regional Director within ten (10) days of adoption by the Board.

Appraisal Policy.

21. Within thirty (30) days, the Association shall revise its appraisal policies and procedures (Appraisal Policy) to ensure that the Association obtains and reviews appraisals in compliance with all applicable laws, regulations, and regulatory guidance. The Association shall ensure that

its Appraisal Policy addresses all corrective actions in the 2010 ROE relating to appraisals, and, at a minimum, shall:

- (a) establish uniform procedures for ordering appraisals;
- (b) ensure the use of certified and appropriately licensed appraisers;
- (c) require systems and procedures to ensure appraisal independence from the lending function;
- (d) require that updated appraisals are obtained when original appraisals are no longer valid;
- (e) require that all appraisals of commercial properties are reviewed by qualified individuals to ensure that the appraisal was prepared properly and represents a reasonable estimate of value; and
- (f) require updated appraisals on all in-substance foreclosure and in-process foreclosure real estate owned (REO) properties in accordance with regulatory guidance, and annual appraisals on all REO.

22. The Board's review of the Appraisal Policy shall be documented in the Board meeting minutes. A copy of the Appraisal Policy shall be provided to the Regional Director within ten (10) days of adoption by the Board.

Interest Reserve Loans.

23. Within sixty (60) days, the Association shall revise its policies and procedures for establishing limits and requirements for the use of interest reserves (Interest Reserve Policy) to ensure that it is acceptable to the Regional Director and addresses all corrective actions addressed in the 2010 ROE relating to interest reserves. The Interest Reserve Policy shall comply with applicable laws, regulations and regulatory guidance, and, at a minimum, include:

(a) identification and reporting to the Board of all loans supported by interest reserves and the amount of remaining interest reserves for each loan; and

(b) identification and reporting the existence of interest reserves on all Asset Workout Plans, Risk Reduction Plans and/or construction loan status reports.

24. The Board's review of the Interest Reserve Policy shall be documented in the Board meeting minutes.

25. Within forty-five (45) days, the Association shall submit to the Board and the Regional Director a written schedule of all outstanding loans with interest reserves (Interest Reserve Schedule).

26. Within thirty (30) days after the close of each quarter, beginning with the quarter ending December 31, 2010, the Association shall update its Interest Reserve Schedule. The Board's review of the Interest Reserve Schedule shall be fully documented in the Board meeting minutes. A copy of the quarterly Interest Reserve Schedule shall be provided to the Regional Director within ten (10) days of review by the Board.

Internal Asset Review and Classification.

27. Within sixty (60) days, the Association shall revise its written internal asset review and classification program (IAR Program) to ensure that it addresses all corrective actions set forth in the 2010 ROE relating to internal asset review and classification and that it complies with all applicable laws, regulations and regulatory guidance. At a minimum, the IAR Program shall:

(a) require the Board to document its quarterly review and approval of any loan rating downgrades or recommended corrective actions as a result of the internal loan review process;

- (b) require the revision of the risk rating definition for the speculative construction loan portfolio to include specific performance criteria; and
- (c) require appropriate classification of the Association's investment securities.

28. The Board's quarterly review of the IAR Program shall be documented in the Board meeting minutes.

Management Plan.

29. Within sixty (60) days, the Board shall prepare and submit to the Regional Director for non-objection, a management plan (Management Plan) that addresses all corrective actions set forth in the 2010 ROE relating to management. At a minimum, the Management Plan shall include:

- (a) evaluation of the performance of the Association's current Senior Executive Officers⁶, including an assessment of whether compensation is commensurate with job duties and responsibilities in compliance with 12 C.F.R. § 563.161(b);
- (b) evaluation of whether the Association has adequate staffing resources and expertise to execute on the strategic direction of the Association, as set forth in the Business Plan required by Paragraph 1 of this Agreement; and
- (c) development of a management succession plan (Management Succession Plan) that is appropriate to the size, complexity, and market circumstances of the Association and will ensure ongoing continuity of overall operations.

30. Upon receipt of written notice of non-objection to the Management Plan from the Regional Director, the Association shall implement and adhere to the Management Plan.

⁶ The term "Senior Executive Officer" is defined at 12 C.F.R. § 563.555.

Vendor Management Program.

31. Within thirty (30) days, the Association shall develop and implement policies and procedures relating to management of its vendors and/or consultants (Vendor Management Program). At a minimum, the Vendor Management Program shall:

- (a) address all recommended corrective actions set forth in the 2010 ROE relating to vendor and/or consultant management;
- (b) address the requirements and guidance of OTS Thrift Bulletin 82a;
- (c) require that all significant contracts⁷ with vendors and/or consultants outline the work to be completed and the planned duration of the project or assignment, with specific time frames for completion of specific tasks;
- (d) include an assessment of the performance of all vendors and/or consultants hired by the Association for significant contracts; and
- (e) provide for detailed processes, reports and systems to facilitate the Board's oversight of the effectiveness of the Vendor Compliance Program.

32. The Board's review and approval of the Vendor Management Program shall be documented in the Board meeting minutes.

Board Oversight of Compliance with Order.

33. Within thirty (30) days, the Board shall: (a) designate a committee to monitor and coordinate the Association's compliance with the provisions of this Agreement and the completion of all corrective actions required in the 2010 ROE (Regulatory Compliance

⁷ For the purposes of this Paragraph, the term "significant contracts" is defined in OTS Bulletin 82a.

Committee), and (b) require the Association to provide sufficient information to the Regulatory Compliance Committee to effectively perform its monitoring responsibilities.

34. Within thirty (30) days after the end of each quarter, beginning with the quarter ending December 31, 2010, the Regulatory Compliance Committee shall submit a written compliance progress report to the Board (Compliance Tracking Report). The Compliance Tracking Report shall, at a minimum:

- (a) separately list each corrective action required by this Agreement and the 2010 ROE;
- (b) identify the required or anticipated completion date for each corrective action; and
- (c) discuss the current status of each corrective action, including the action(s) taken or to be taken to comply with each corrective action.

35. Within sixty (60) days after the end of each quarter, beginning with the quarter ending December 31, 2010, the Board shall review the Compliance Tracking Report and all reports required to be prepared by this Agreement. Following its review, the Board shall adopt a resolution: (a) certifying that each director has reviewed the Compliance Tracking Report and all required reports; and (b) documenting any corrective actions adopted by the Board. A copy of the Compliance Tracking Report and the Board resolution shall be provided to the Regional Director within ten (10) days after the Board meeting.

36. Nothing contained herein shall diminish the responsibility of the entire Board to ensure the Association's compliance with the provisions of this Agreement. The Board shall review and adopt all policies and procedures required by this Agreement prior to submission to the OTS.

Growth.

37. Effective immediately, the Association shall not increase its total assets during any quarter in excess of an amount equal to net interest credited on deposit liabilities during the prior quarter without the prior written notice of non-objection of the Regional Director.

Brokered Deposits.

38. Effective immediately, the Association shall comply with the requirements of 12 C.F.R. § 337.6(b).

Directorate and Management Changes.

39. Effective immediately, the Association shall comply with the prior notification requirements for changes in directors and Senior Executive Officers set forth in 12 C.F.R. Part 563, Subpart H.

Golden Parachute and Indemnification Payments.

40. Effective immediately, the Association shall not make any golden parachute payment⁸ or prohibited indemnification payment⁹ unless, with respect to each such payment, the Association has complied with the requirements of 12 C.F.R. Part 359 and, as to indemnification payments, 12 C.F.R. § 545.121.

Employment Contracts and Compensation Arrangements.

41. Effective immediately, the Association shall not enter into, renew, extend or revise any contractual arrangement relating to compensation or benefits for any Senior Executive Officer or director of the Association, unless it first provides the Regional Director with not less than sixty (60) days prior written notice of the proposed transaction. The notice to the Regional Director

⁸ The term "golden parachute payment" is defined at 12 C.F.R. § 359.1(f).

⁹ The term "prohibited indemnification payment" is defined at 12 C.F.R. § 359.1(l).

shall include a copy of the proposed employment contract or compensation arrangement or a detailed, written description of the compensation arrangement to be offered to such officer or director, including all benefits and perquisites. The Board shall ensure that any contract, agreement or arrangement submitted to the Regional Director fully complies with the requirements of 12 C.F.R. Part 359, 12 C.F.R. §§ 563.39 and 563.161(b), and 12 C.F.R. Part 570 – Appendix A.

Dividends and Other Capital Distributions.

42. Effective immediately, the Association shall not declare or pay dividends or make any other capital distributions, as that term is defined in 12 C.F.R. § 563.141, without receiving the prior written approval of the Regional Director in accordance with applicable regulations and regulatory guidance. The Association’s written request for approval shall be submitted to the Regional Director at least thirty (30) days prior to the anticipated date of the proposed declaration, dividend payment or distribution of capital.

Effective Date.

43. This Agreement is effective on the Effective Date as shown on the first page.

Duration.

44. This Agreement shall remain in effect until terminated, modified or suspended, by written notice of such action by the OTS, acting by and through its authorized representatives.

Time Calculations.

45. Calculation of time limitations for compliance with the terms of this Agreement run from the Effective Date and shall be based on calendar days, unless otherwise noted.

Submissions and Notices.

46. All submissions to the OTS that are required by or contemplated by the Agreement shall be submitted within the specified timeframes.

47. Except as otherwise provided herein, all submissions, requests, communications, consents or other documents relating to this Agreement shall be in writing and sent by first class U.S. mail (or by reputable overnight carrier, electronic facsimile transmission or hand delivery by messenger) addressed as follows:

- (a) To the OTS:
Office of Thrift Supervision
Attn: Michael E. Finn
Regional Director, Northeast Region
Harborside Financial Center Plaza Five
Suite 1600
Jersey City, NJ 07302
Fax: (201) 413-7543

With a copy to:
Michael Moriarty
Office of Thrift Supervision
Assistant Director, Northeast Region
Suite 201
35 Braintree Hill Office Park
Braintree, MA 02184

- (b) To Middlesex Federal Savings, F.A.:
Attn: Joseph S. Smalarz, President
1 College Avenue
PO Box 440303
Somerville, MA 02144

No Violations Authorized.

48. Nothing in this Agreement shall be construed as allowing the Association, its Board, officers or employees to violate any law, rule, or regulation.

OTS Authority Not Affected.

49. Nothing in this Agreement shall inhibit, estop, bar or otherwise prevent the OTS from taking any other action affecting the Association if at any time the OTS deems it appropriate to do so to fulfill the responsibilities placed upon the OTS by law.

Other Governmental Actions Not Affected.

50. The Association acknowledges and agrees that its execution of the Agreement is solely for the purpose of resolving the matters addressed herein, consistent with Paragraph 49 above, and does not otherwise release, discharge, compromise, settle, dismiss, resolve, or in any way affect any actions, charges against, or liability of the Association that arise pursuant to this action or otherwise, and that may be or have been brought by any governmental entity other than the OTS.

Miscellaneous.

51. The laws of the United States of America shall govern the construction and validity of this Agreement.

52. If any provision of this Agreement is ruled to be invalid, illegal, or unenforceable by the decision of any Court of competent jurisdiction, the validity, legality, and enforceability of the remaining provisions hereof shall not in any way be affected or impaired thereby, unless the Regional Director in his or her sole discretion determines otherwise.

53. All references to the OTS in this Agreement shall also mean any of the OTS's predecessors, successors, and assigns.

54. The section and paragraph headings in this Agreement are for convenience only and shall not affect the interpretation of this Agreement.

55. The terms of this Agreement represent the final agreement of the parties with respect to the subject matters thereof, and constitute the sole agreement of the parties with respect to such subject matters.

Enforceability of Agreement.

56. This Agreement is a “written agreement” entered into with an agency within the meaning and for the purposes of 12 U.S.C. § 1818.

Signature of Directors/Board Resolution.

57. Each Director signing this Agreement attests that he or she voted in favor of a Board Resolution authorizing the consent of the Association to the issuance and execution of the Agreement. This Agreement may be executed in counterparts by the directors after approval of execution of the Agreement at a duly called board meeting. A copy of the Board Resolution authorizing execution of this Agreement shall be delivered to the OTS, along with the executed original(s) of this Agreement.

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WHEREFORE, the OTS, acting by and through its Regional Director, and the Board of the Association, hereby execute this Agreement.

MIDDLESEX FEDERAL SAVINGS, F.A.
Somerville, Massachusetts

OFFICE OF THRIFT SUPERVISION

By: _____/s/_____
John D. Champi, Director

By: _____/s/_____
Michael E. Finn
Regional Director, Northeast Region

By: _____/s/_____
Joseph S. Smalarz, Director

By: _____/s/_____
Joseph J. Sullivan, Director

By: _____/s/_____
John R. Wiseman, III, Director

By: _____/s/_____
Daniel F. Wiseman, Director