CIMAREX ENERGY CO
Form 11-K
May 05, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D C 20549

Form 11-K

x ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

OR

o TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 001-31446

A. Full title of the plan and the address of the plan, if different from that of the issuer named below:

CIMAREX ENERGY CO. 401(k) PLAN

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

CIMAREX ENERGY CO.

1700 Lincoln Street, Suite 3700, Denver, Colorado 80203

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Cimarex Energy Co.

401(k) Plan

Financial Statements

and Supplemental Schedule

As of December 31, 2015 and 2014

and for the Year Ended December 31, 2015

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Cimarex Energy Co.

401(k) Plan

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Report of Independent Registered Public Accounting Firm

To the Plan Administrator

Cimarex Energy Co. 401(k) Plan

Denver, Colorado

We have audited the accompanying statements of net assets available for plan benefits of the Cimarex Energy Co. 401(k) Plan (the Plan) as of December 31, 2015 and 2014, and the related statement of changes in net assets available for plan benefits for the year ended December 31, 2015. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Plan is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for plan benefits of the Plan as of December 31, 2015 and 2014, and the changes in net assets available for plan benefits for the year ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

The accompanying supplemental schedule of assets (held at end of year) as of December 31, 2015 has been subjected to audit procedures performed in conjunction with the audit of the Plan s financial statements. The supplemental information is presented for the purpose of additional analysis and is not a required part of the financial statements but include supplemental information required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental information is the responsibility of the Plan s management. Our audit procedures included determining whether the supplemental information reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental information. In forming our opinion on the supplemental information in the accompanying schedules, we evaluated whether the supplemental information, including its form and content, is presented in conformity with the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. In our opinion, the supplemental information in the accompanying schedule is fairly stated, in all material respects, in relation to the financial statements as a whole.

/s/Anton Collins Mitchell LLP

Denver, Colorado

May 3, 2016

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Financial Statements

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Cimarex Energy Co.

401(k) Plan

Statements of Net Assets Available for Plan Benefits

December 31,		2015		2014
Assets:				
Investments, at fair value:				
Registered investment companies	**$**	**152,032,266**	$	97,348,252
Common/collective trusts				51,729,331
Cimarex Energy Co. Common Stock Fund		**20,098,445**		25,182,709
Total investments		**172,130,711**		174,260,292
Receivables:				
Notes receivable from participants		**1,787,076**		1,577,571
Employer profit sharing contributions, net of forfeitures				1,814,065
Total receivables		**1,787,076**		3,391,636
Net assets available for plan benefits	**$**	**173,917,787**	$	177,651,928

The accompanying notes are an integral part of these financial statements.

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Cimarex Energy Co.

401(k) Plan

Statement of Changes in Net Assets Available for Plan Benefits

For the Year Ended December 31,		**2015**
Additions to net assets attributed to:		
Contributions:		
Participant	$	**9,244,723**
Employer match, net of forfeitures		**7,274,292**
Participant rollover		**1,072,238**
Interest earned on notes receivable from participants		**69,836**
Investment income:		
Interest and dividends		**3,355,052**
Total additions		**21,016,141**
Deductions from net assets attributed to:		
Benefits paid to participants, including loans deemed distributed		**16,984,761**
Net depreciation in fair value of investments		**7,739,924**
Administrative expenses		**25,597**
Total deductions		**24,750,282**
Net decrease		**(3,734,141)**
Net assets available for plan benefits, beginning of year		**177,651,928**
Net assets available for plan benefits, end of year	$	**173,917,787**

The accompanying notes are an integral part of these financial statements.

Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

1. PLAN DESCRIPTION

The following is a brief description of the Cimarex Energy Co. 401(k) Plan (the Plan) and is provided for general information only. Participants should refer to the Plan Document or Summary Plan Description for a more complete description of the Plan s provisions.

The Plan was established by Cimarex Energy Co. (the Company or Cimarex) in 2002, and most recently restated effective January 1, 2015. The Plan was established to provide incentives and security for the employees of the Company and their beneficiaries. In addition to Cimarex employees, the Plan provides for participation by employees of all Cimarex subsidiaries. The Plan is intended to be a defined contribution plan with profit sharing provisions.

General

The Plan is a defined contribution plan covering employees of Cimarex and its participating subsidiaries. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). The Plan is not covered by the Pension Benefit Guaranty Corporation.

Trustee and Recordkeeper of the Plan

The trustee of the Plan is Vanguard Fiduciary Trust Company (the Trustee or Vanguard). The Trustee holds all assets of the Plan in accordance with provisions of the agreement with the Company. All assets of the Plan are held in trust by Vanguard. Vanguard is also the recordkeeper of the Plan.

Eligibility

All non-excludable employees of the Company who have attained the age of 18 are eligible to participate in the Plan upon date of hire. Excludable employees include leased employees, members of a collective bargaining unit, commissioned salespersons, independent contractors

and non-resident aliens. Employees may enter the Plan on the first day of each calendar month after meeting plan requirements. A participant may modify his/her deferral election at the times determined by the Plan Administrator.

Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

1. PLAN DESCRIPTION (CONTINUED)

Contributions

The contributions (participant and Company) for the plan year are subject to certain limitations imposed by the Internal Revenue Code (IRC) and the Plan s terms.

A participant may enter into a salary reduction agreement with the Company whereby the amount withheld is contributed to the Plan during the plan year on behalf of each participant (as an employee s elective 401(k) deferred salary contribution or as a Roth after tax contribution). In no event shall the portion of earnings to be deferred be less than 1% of the participant s earnings nor more than 100% of the participant s pre-tax annual compensation, as defined in the Plan Document, subject to annual IRC dollar limits ($18,000 for 2015). The Plan also allows catch-up contributions for participants over the age of 50 based on IRC limitations ($6,000 for 2015).

The Company may make a matching contribution to the Plan during the plan year, on behalf of each participant, equal to 100% of the contributions made by the participant pursuant to the written salary reduction agreement between the participant and the Company. In no event shall the Company s matching contribution, on behalf of a participant, exceed the match percentage approved by the Company s Board of Directors, which was 7% of each participant s eligible compensation for 2015. The matching contribution is also subject to the IRC annual compensation limit ($265,000 for 2015). Catch-up contributions are not matched by the Company.

The Plan also allows for a profit sharing contribution by the employer. The Company made a profit sharing contribution for the year ended December 31, 2014 in the amount of $1,814,065, which was equal to 2% of eligible compensation (after forfeitures were applied) and which was funded in 2015. The Company did not make a profit sharing contribution for the year ended December 31, 2015. Employees are eligible to receive the profit sharing contribution if they meet the plan entry requirements, are employed on the last day of the plan year and have a minimum of 500 hours of service in the plan year. For employees who terminated employment due to death, disability or had attained age 62, the last day of year and 500 hour service requirements do not apply.

Employees can make rollover contributions from other qualified plans if certain criteria are met as outlined in the Plan Document.

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

1. PLAN DESCRIPTION (CONTINUED)

Participant Accounts

Each participant s account is credited with the participant s contributions, the Company s matching contributions, profit sharing contributions (if any), and earnings and losses on investments, and is charged with the participant s withdrawals and distributions on a daily basis. The investment earnings or losses are allocated to each participant s account in the proportion that the balance of each participant s account bears to the total balance of all participants in each investment fund. The benefit to which a participant is entitled is the benefit that can be provided from the participant s vested account. Participants may elect to transfer balances between investment funds within their account at any time.

Investment Options

Participants may direct the investment of their account balance into various investment options offered by the Plan. Currently, the Plan offers various investment options in registered investment companies and a Cimarex Energy Co. common stock fund. Participants may change their investment directions at any time, subject to such restrictions and procedures as established by the recordkeeper, the Plan and Cimarex. Employee-participants are not permitted to trade company stock while in possession of material, undisclosed information about the Company.

Notes Receivable from Participants

An employee may borrow the lesser of $50,000 or one-half of their vested account balance. Participants may not have more than one loan outstanding at any time and the minimum original loan amount is $1,000. Participants may not apply for another loan within six months of the date on which the previous loan was paid in full. The maximum loan term is five years, except for a loan to acquire a participant s principal residence, which may have a term of up to ten years. A participant s loan shall become due and payable if such participant fails to make a principal and/or interest payment as provided in the loan agreement, subject to a short grace period. The loans are secured by the balance in the participant s account, and bear interest at a rate of 1% above prime rate. Interest rates for the loans range from 4.25% to 8.25% as of December 31, 2015. Principal and interest are paid ratably through payroll deductions.

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

1. PLAN DESCRIPTION (CONTINUED)

Vesting

A participant is always 100% vested in that portion of his/her account attributable to 401(k) deferred salary contributions, Roth contributions, catch-up contributions and rollover contributions. Vesting for that portion of the participant s account attributable to Company contributions is based on years of credited service as defined by the Plan Document, in accordance with the following schedule:

Completed years of credited service with the Company	Vested Percentage
1	25%
2	50%
3	75%
4 or more	100%

Participants also become fully vested in their accounts upon reaching normal retirement age (62), death or disability.

Forfeitures

At December 31, 2015 and 2014, amounts held in the forfeiture account totaled $148,106 and $203,607, respectively. These amounts can be used to reduce future employer contributions. For the year ended December 31, 2014, forfeitures of $127,000 were utilized to fund the December 31, 2014 employer profit sharing contributions, with the balance funded in 2015. The Company utilized $108,079 of forfeitures in 2016 to fund the 2015 match true up contribution. Remaining unused forfeiture amounts have not been allocated to participant accounts.

Plan Expenses

Loan origination and annual fees are paid by participants who take out loans. During the year ended December 31, 2015, expenses of $25,597 were paid by or allocated to participants. All other administrative expenses of the Plan are paid by the Company and are excluded from these

financial statements.

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

1. PLAN DESCRIPTION (CONTINUED)

Plan Termination

Although it has not expressed any intent to do so, the Company has the right under the Plan to terminate the Plan, subject to the provisions of ERISA. In the event the Plan is terminated, all participant accounts would immediately become fully vested and the assets would be distributed among the participants in accordance with the terms set forth in the Plan.

Payment of Benefits

Upon termination of service, death, disability or attainment of the normal retirement age (62), a participant may elect to receive a lump-sum distribution equal to the vested value of the participant s account, or transfer the vested balance to another qualified retirement plan or individual retirement account. Immediate lump-sum distributions are to be made to terminated participants if the participant s vested account balance, net of rollover contributions, is $1,000 or less. Participants may request to receive Company stock held in their account as an in-kind distribution.

Participants may also take certain voluntary in-service withdrawals and hardship withdrawals if certain criteria are met.

Voting Rights of Company Common Stock

The Trustee, holds the shares of Cimarex common stock on behalf of the Plan. Each participant or beneficiary of a deceased participant shall have the right to direct the Trustee as to the manner of voting and the exercise of all other rights which a shareholder of record has with respect to shares of Company stock which have been allocated to the participant s account including, but not limited to, the right to sell or retain shares in a public or private tender offer. Participants direct the Trustee to vote by submission of timely participant directions. Shares held by Vanguard for which timely participant directions are not received are voted in the same proportion as the shares for which the Trustee received timely participant directions, except in the case where to do so would be inconsistent with the provisions of Title I of ERISA.

Basis of Accounting

The financial statements of the Plan are prepared using the accrual method of accounting.

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP) requires the Plan Administrator to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates and such differences could be material.

Valuation of Investments and Income Recognition

The Plan s investments are stated at fair value, which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 4 for fair value measurements.

Purchases and sales of investments are recorded on a trade-date basis. Interest income is accrued when earned. Dividend income is recorded on the ex-dividend date. Capital gain distributions are included in dividend income. The net appreciation in the fair value of investments consists of the realized gains (losses) and the unrealized appreciation (depreciation) on those investments.

Notes Receivable from Participants

Notes receivable from participants are measured at their unpaid principal balance; any accrued and unpaid interest was de minimis. Delinquent notes receivables are reclassified as distributions based upon the terms of the Plan document.

Payment of Benefits

Benefits are recorded when paid. As of December 31, 2015 and 2014, there were no distributions requested that had not been paid.

Contributions

Participant contributions and related matching contributions are recorded in the period payroll deductions are made. Profit sharing contributions are recorded for the year to which they apply.

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New Accounting Pronouncements

In May 2015, the Financial Accounting Standards Board (FASB) issued ASU 2015-07, *Fair Value Measurement (Topic 820), Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), (ASU 2015-07).* The amendments in ASU 2015-07 remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also remove the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. The amendments in ASU 2015-07 are effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Plan decided not to early adopt ASU 2015-07, and the adoption of this guidance is not expected to have a material effect on these financial statements.

In July 2015, the FASB issued ASU No. 2015-12, *Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965), I. Fully Benefit-Responsive Investment Contracts, II. Plan Investment Disclosures, III. Measurement Date Practical Expedient* (ASU 2015-12). The FASB is issuing this update in response to a proposal developed by the Emerging Issues Task Force (EITF) to reduce complexity in employee benefit plan accounting.

Part I of ASU 2015-12 requires fully benefit-responsive investment contracts to be measured, presented and disclosed at contract value. Contract value is the relevant measure for those contracts because that is the amount participants normally would receive if they were to initiate permitted transactions under the terms of the Plan.

Part II of ASU 2015-12 requires that investments (both participant-directed and nonparticipant-directed) of employee benefit plans be grouped only by general type, such as the following: registered investment companies, government securities, common-collective trusts, pooled separate accounts, short-term securities, corporate bonds, common stock, mortgages, real estate and self-directed brokerage accounts. Plans will be required to disclose the net appreciation or depreciation in fair value of investments in aggregate, but will no longer be required to be disaggregated and disclosed by general type. In addition, if an investment is measured using the net asset value per share (or its equivalent) practical expedient and that investment is in a fund that files a U.S. Department of Labor Form 5500 as a direct filing entity, disclosure of that investment s strategy will no longer be required.

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Part III of ASU 2015-12 provides a practical expedient to permit plans to measure investments and investment related accounts (for example, a liability for a pending trade with a broker) as of a month-end that is closest to the plan s fiscal year end, when the fiscal period does not coincide with a month-end. If a plan applies the practical expedient and a contribution, distribution, and/or significant event occurs between the alternative measurement date and the plan s fiscal year end, the plan should disclose the amount of the contribution, distribution, and/or significant event.

The amendments in ASU 2015-12 are effective for fiscal years beginning after December 15, 2015; early application is permitted.

The Plan decided not to early adopt ASU 2015-12, and the adoption of this guidance is not expected to have a material effect on these financial statements.

Subsequent events

Management has evaluated subsequent events through April 26, 2016, which is the date the financial statements were available to be issued. There were no events or transactions discovered during this evaluation that require recognition or disclosure in the financial statements.

3. INVESTMENTS

During 2015, the Plan s investments (including gains and losses on investments bought and sold, as well as held during the year ended December 31, 2015) appreciated (depreciated) in value as follows:

For the Year Ended December 31,		**2015**
Registered investment companies	**$**	**(5,906,516)**

Common/Collective Trust		1,726,602
Cimarex Energy Co. Common Stock Fund		(3,560,010)
Net depreciation in fair value of investments	$	(7,739,924)

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

3. INVESTMENTS (CONTINUED)

Investments which exceed 5% of net assets available for Plan benefits are as follows:

December 31,	2015	2014
Cimarex Energy Co. Common Stock	**$ 20,001,814**	$ 25,125,180
Vanguard Prime Money Market Fund (a)	**18,291,800**	19,605,354
Vanguard Institutional Index Fund	**15,047,400**	15,366,477
Vanguard Wellington Fund Admiral Shares	**12,509,252**	12,918,032
Vanguard Target Retirement 2025 Fund	**11,389,815**	*
Vanguard Target Retirement 2025 Trust II	*	11,317,348
Vanguard Small-Cap Index Fund Signal Shares	**9,254,794**	10,858,496
Vanguard Intermediate-Term Treasury Fund Admiral Shares	**12,967,901**	9,392,322
Vanguard Windsor II Fund Admiral Shares	*	8,978,536

**Not greater than 5% in the respective year*

(a) The balance held includes amounts held by the Cimarex Energy Co. Common Stock Fund, as required by the look through rules.

4. FAIR VALUE MEASUREMENTS

ASC 820 established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy consists of three broad levels. Level 1 inputs are the highest priority and consist of unadjusted quoted prices in active markets for identical assets and liabilities. Level 2 inputs are inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for an asset or liability.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2015 and 2014.

Registered Investment Companies: Valued at quoted market prices in active markets that the Plan has the ability to access, which represent the net asset value of shares held by the Plan at year-end and are Level 1 investments.

Cimarex Energy Co. Common Stock: Valued at year-end unit closing price reported on the active market on which the securities are traded (comprised of year-end market price of the stock plus uninvested cash position) and are Level 1 investments.

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

4. FAIR VALUE MEASUREMENTS (CONTINUED)

Common/Collective Trusts: The investments include lifecycle (targeted maturity funds) and a fixed income fund. The fair values of the Plan s interest in the funds are based on the net asset values (NAV) reported by the fund managers as of the financial statement dates and recent transaction prices. The funds provide for daily redemptions by the Plan at reported NAV with no advance notice requirement. Under unusual circumstances, redemptions may be suspended should the withdrawal cause a material adverse impact on other participating plans. Fair values for the investments within these funds are based on quoted prices in active markets and securities valued using either observable inputs or quotations from inactive markets. The Plan is permitted to redeem investment units at NAV on the measured date, and as a result, the investments are classified as a Level 2 investment. These funds have various investment objectives depending on the investment strategy of the fund as provided and available to plan participants through a variety of participating communications, and as indicated by asset category on the fair value hierarchy tables. These investments were liquidated in 2015, and there were no expenses or market value adjustments related to this liquidation.

The following table sets forth by level, within the fair value hierarchy, the Plan s assets measured on a recurring basis as of December 31, 2015:

	Level 1	Level 2	Level 3	Total
Registered investment companies:				
Domestic equity funds	$ **41,952,297**	$	$	$ **41,952,297**
International equity funds	**9,858,901**			**9,858,901**
Bond funds	**17,163,897**			**17,163,897**
Balanced funds	**64,862,002**			**64,862,002**
Money market funds	**18,291,800**			**18,291,800**
Common stock:				
Company stock	**20,001,814**			**20,001,814**
Total investments, at fair value	$ **172,130,711**	$	$	$ **172,130,711**

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

4. FAIR VALUE MEASUREMENTS (CONTINUED)

The following table sets forth by level, within the fair value hierarchy, the Plan s assets measured on a recurring basis as of December 31, 2014:

	Level 1	Level 2	Level 3	Total
Registered investment companies:				
Domestic equity funds	$ 44,246,369	$	$	$ 44,246,369
International equity funds	8,970,123			8,970,123
Bond funds	11,665,902			11,665,902
Balanced funds	12,918,032			12,918,032
Money market funds	19,605,355			19,605,355
Common stock:				
Company stock	25,125,180			25,125,180
Common/collective trusts:				
Balanced funds		51,729,331		51,729,331
Total investments, at fair value	$ 122,530,961	$ 51,729,331	$	$ 174,260,292

5. INCOME TAX STATUS

The prototype plan, which the Company adopted January 1, 2015, obtained its latest opinion letter on May 28, 2014. The Internal Revenue Service (IRS) has stated that the prototype plan is qualified and the related trust is tax-exempt.

Accounting principles generally accepted in the United States of America require plan management to evaluate tax positions taken by the Plan and recognize a tax liability (or asset) if the Plan has taken an uncertain position that more likely than not would not be sustained upon examination by the IRS. The plan administrator has analyzed the tax positions taken by the Plan, and has concluded, as of December 31, 2015, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the financial statements. The Plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income tax examinations for years prior to 2012.

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Cimarex Energy Co.

401(k) Plan

Notes to Financial Statements

6. RELATED PARTY/ PARTY-IN-INTEREST TRANSACTIONS

The Plan invests in shares of registered investment companies managed by an affiliate of Vanguard. Vanguard acts as trustee and recordkeeper for the Plan. During the plan year ended December 31, 2015, annual administrative fees of $25,597 were paid to Vanguard. The Plan also issues loans to participants which are secured by the vested portion of the participant s accounts.

The Plan also invests in Cimarex Energy Co. common stock, common stock of the plan sponsor, which also qualifies as a related party transaction. During the plan year ended December 31, 2015, the loss on investment was $3,411,183 (including $148,827 dividends reinvested), purchases of Cimarex common stock were $2,697,172, sales of Cimarex common stock were $1,434,612 and net transfer out of Cimarex common stock was $2,935,641. As of December 31, 2015 and 2014, the Plan held 223,784 and 237,030 shares of Cimarex common stock at a value of $20,001,814 and $25,125,180, respectively, along with cash in the Vanguard Prime Money Market Fund of $96,631 and $57,529, respectively, in the Cimarex Energy Co. Common Stock Fund. Transactions in such investments qualify as party-in-interest transactions, which are exempt from the prohibited transaction rules.

7. CONCENTRATIONS, RISKS AND UNCERTAINTIES

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risk. Additionally, the value, liquidity and related income of the investment securities are sensitive to changes in economic conditions, including delinquencies or defaults, and may be adversely affected by shifts in the market s perceptions of the issuers and changes in interest rates. Shares of the Company s common stock are also exposed to the same risks as well as risks specific to the Company, which are detailed in the Company s filings with the Securities and Exchange Commission. Investment in the Company s common stock represents 12% and 14% of the net assets available for plan benefits as of December 31, 2015 and 2014, respectively. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in value in the near term would materially affect the amounts reported in the statement of net assets available for plan benefits and participants accounts.

Additionally, certain registered investment companies investments are invested in the securities of foreign companies, which involve special risks and considerations not typically associated with investing in U.S. companies. These risks include devaluation of currencies, less reliable information about issuers, different securities transaction clearance and settlement practices and possible adverse political and economic developments. Moreover, securities of many foreign companies and their markets may be less liquid and their prices more volatile than those of securities of comparable U.S. companies.

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8. RECONCILIATION OF FINANCIAL STATEMENTS TO FORM 5500

Participant loans are reported as notes receivable from participants in the accompanying financial statements as required by current authoritative guidance; however, for Form 5500 purposes and reporting on the supplemental Schedule of Assets (Held at End of Year) they are shown as investments, as required.

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Supplemental Schedule

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Cimarex Energy Co.

401(k) Plan

Form 5500 - Schedule H, Part IV, Line 4i - Schedule of Assets

(Held at End of Year) December 31, 2015

EIN: 45-0466694

Plan Number: 001

(a)	(b) Identity of Issue, Borrower, Lessor or Similar Party	(c) Description of Investment	(d) Shares/ Units	(e) Cost		(f) Current Value
*	Vanguard Prime Money Market Fund	Registered Investment Company	18,195,169.120	(1)	$	18,195,169
	American Funds EuroPacific Growth Fund	Registered Investment Company	85,457.066	(1)		3,872,914
	PIMCO Total Return Fund Institutional Class	Registered Investment Company	241,775.442	(1)		2,434,679
*	Vanguard Growth Index Fund Institutional Shares	Registered Investment Company	137,667.653	(1)		7,540,057
*	Vanguard Institutional Index Fund	Registered Investment Company	80,631.231	(1)		15,047,400
*	Vanguard Short-Term Investment-Grade Fund Admiral Shares	Registered Investment Company	166,791.439	(1)		1,761,317
*	Vanguard Small-Cap Index Fund Signal Shares	Registered Investment Company	174,454.166	(1)		9,254,794
*	Vanguard Intermediate-Term Treasury Fund Admiral Shares	Registered Investment Company	1,151,678.621	(1)		12,967,901
*	Vanguard Mid-Cap Index Fund Admiral Shares	Registered Investment Company	16,909.040	(1)		2,514,712
*	Vanguard Total International Stock Admiral Shares	Registered Investment Company	246,946.657	(1)		5,985,987
*	Vanguard Wellington Fund Admiral Shares	Registered Investment Company	196,872.081	(1)		12,509,252
*	Vanguard Windsor II Fund Admiral Shares	Registered Investment Company	127,781.525	(1)		7,595,334
*	Vanguard Target Retirement 2010 Fund	Registered Investment Company	24,886.787	(1)		486,288
*	Vanguard Target Retirement 2015 Fund	Registered Investment Company	238,247.893	(1)		4,605,332
*	Vanguard Target Retirement 2020 Fund	Registered Investment Company	413,678.561	(1)		7,938,492
*	Vanguard Target Retirement 2025 Fund	Registered Investment Company	597,263.487	(1)		11,389,815
*	Vanguard Target Retirement 2030 Fund	Registered Investment Company	278,314.062	(1)		5,271,268
*	Vanguard Target Retirement 2035 Fund	Registered Investment Company	286,368.522	(1)		5,389,456
*	Vanguard Target Retirement 2040 Fund	Registered Investment Company	181,182.078	(1)		3,386,293
*	Vanguard Target Retirement 2045 Fund	Registered Investment Company	318,523.374	(1)		5,953,202
*	Vanguard Target Retirement 2050 Fund	Registered Investment Company	194,526.040	(1)		3,635,692
*	Vanguard Target Retirement 2055 Fund	Registered Investment Company	91,166.711	(1)		1,703,906
*	Vanguard Target Retirement 2060 Fund	Registered Investment Company	19,266.410	(1)		359,896
*	Vanguard Target Retirement Income Fund	Registered Investment Company	113,934.167	(1)		2,233,110
*	Cimarex Energy Co. Common Stock	Common Stock	223,784.000	(1)		20,001,814
*	Vanguard Prime Money Market Fund		96,631.280	(1)		96,631

		Registered Investment Company in Company Stock Fund		
*	Participant Loans	Ranging from 4.25% to 8.25%, various maturity dates	(1)	1,787,076
				$ 173,917,787

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* Party-in-interest as defined by ERISA.

(1) The cost of participant-directed investments is not required to be disclosed.

See accompanying report of independent registered public accounting firm.

Table of Contents

SIGNATURE

The Plan. Pursuant to the requirements of the Securities Exchange Act of 1934, the trustees (or other persons who administer the employee benefit plan) have duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Cimarex Energy Co. 401(k) Plan

Date: May 3, 2016

BY: /s/ Richard S. Dinkins
Richard S. Dinkins
Vice President-Human Resources of
Cimarex Energy Co. and
Plan Administrator of Cimarex Energy Co. 401(k) Plan

BY: /s/ Sherri M. Nitta
Sherri M. Nitta
Treasurer of
Cimarex Energy Co. and
Plan Administrator of Cimarex Energy Co.
401(k) Plan

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inline; FONT-FAMILY: times new roman; FONT-SIZE: 10pt"> 5,111 1,893
Commercial and industrial
10 1,129 1,111
Mortgage

1-4 family
59 7,663 7,540
Resort lending
27 7,474 7,393

Home equity line of credit - 1st lien	1	45	47
Home equity line of credit - 2nd lien	1	23	19
Installment			
Home equity installment - 1st lien	18	475	470
Home equity installment - 2nd lien	14	464	450
Loans not secured by real estate	23	411	404
Other	-	-	-
Total	172	$37,588	$33,255

The troubled debt restructurings described above for 2012 increased the allowance for loan losses by $0.4 million and resulted in zero charge offs during the three months ended September 30, 2012, respectively and increased the allowance by $1.5 million and resulted in $0.4 million charge offs during the nine months ended September 30, 2012, respectively.

The troubled debt restructurings described above for 2011 increased the allowance for loan losses by $0.1 million and resulted in charge offs of $0.3 million during the three months ended September 30, 2011, respectively and increased the allowance by $0.7 million and resulted in charge offs of $3.8 million during the nine months ended September 30, 2011, respectively.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Loans that have been classified as troubled debt restructurings during the past twelve months and that have subsequently defaulted during the three-month periods ended September 30 follow:

	Number of Contracts	Recorded Balance
2012	(Dollars in thousands)	
Commercial		
Income producing - real estate	2	$827
Land, land development & construction-real estate	-	-
Commercial and industrial	-	-
Mortgage		
1-4 family	-	-
Resort lending	2	468
Home equity line of credit - 1st lien	-	-
Home equity line of credit - 2nd lien	-	-
Installment		
Home equity installment - 1st lien	-	-
Home equity installment - 2nd lien	-	-
Loans not secured by real estate	-	-
Other	-	-
	4	$1,295
2011		
Commercial		
Income producing - real estate	1	$136
Land, land development & construction-real estate	-	-
Commercial and industrial	-	-
Mortgage		
1-4 family	4	607
Resort lending	1	340
Home equity line of credit - 1st lien	-	-
Home equity line of credit - 2nd lien	-	-
Installment		
Home equity installment - 1st lien	-	-
Home equity installment - 2nd lien	1	46
Loans not secured by real estate	-	-
Other	-	-
	7	$1,129

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Loans that have been classified as troubled debt restructurings during the past twelve months and that have subsequently defaulted during the nine-month periods ended September 30 follows:

	Number of Contracts	Recorded Balance
2012	(Dollars in thousands)	
Commercial		
Income producing - real estate	2	$827
Land, land development & construction-real estate	1	136
Commercial and industrial	7	520
Mortgage		
1-4 family	2	148
Resort lending	3	584
Home equity line of credit - 1st lien	-	-
Home equity line of credit - 2nd lien	-	-
Installment		
Home equity installment - 1st lien	1	26
Home equity installment - 2nd lien	1	20
Loans not secured by real estate	-	-
Other	-	-
	17	$2,261
2011		
Commercial		
Income producing - real estate	3	$1,042
Land, land development & construction-real estate	1	1,222
Commercial and industrial	-	-
Mortgage		
1-4 family	8	1,024
Resort lending	5	1,128
Home equity line of credit - 1st lien	-	-
Home equity line of credit - 2nd lien	-	-
Installment		
Home equity installment - 1st lien	1	19
Home equity installment - 2nd lien	4	264
Loans not secured by real estate	-	-
Other	-	-
	22	$4,699

A loan is considered to be in payment default generally once it is 90 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above for 2012 increased the allowance for loan losses by $0.7 million and resulted in zero charge offs during the three months ended September 30, 2012, respectively and increased the allowance for loan losses by $0.7 million and resulted in charge offs of $0.4 million during the nine months ended September 30, 2012, respectively.

The troubled debt restructurings that subsequently defaulted described above for 2011 increased the allowance for loan losses by $0.2 million and resulted in charge offs of $0.1 million during the three months ended September 30, 2011, respectively and decreased the allowance for loan losses by $0.4 million and resulted in charge offs of $1.5 million during the nine months ended September 30, 2011, respectively.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The terms of certain other loans were modified during the three and nine months ended September 30, 2012 and 2011 that did not meet the definition of a troubled debt restructuring. The modification of these loans could have included modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

In order to determine whether a borrower is experiencing financial difficulty, we perform an evaluation of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under our internal underwriting policy.

Credit Quality Indicators – As part of our on on-going monitoring of the credit quality of our loan portfolios, we track certain credit quality indicators including (a) weighted-average risk grade of commercial loans, (b) the level of classified commercial loans (c) credit scores of mortgage and installment loan borrowers (d) investment grade of certain counterparties for payment plan receivables and (e) delinquency history and non-performing loans.

For commercial loans we use a loan rating system that is similar to those employed by state and federal banking regulators. Loans are graded on a scale of 1 to 12. A description of the general characteristics of the ratings follows:

Rating 1 through 6: These loans are generally referred to as our "non-watch" commercial credits that include very high or exceptional credit fundamentals through acceptable credit fundamentals.

Rating 7 and 8: These loans are generally referred to as our "watch" commercial credits. This rating includes loans to borrowers that exhibit potential credit weakness or downward trends. If not checked or cured these trends could weaken our asset or credit position. While potentially weak, no loss of principal or interest is envisioned with these ratings.

Rating 9: These loans are generally referred to as our "substandard accruing" commercial credits. This rating includes loans to borrowers that exhibit a well-defined weakness where payment default is probable and loss is possible if deficiencies are not corrected. Generally, loans with this rating are considered collectible as to both principal and interest primarily due to collateral coverage.

Rating 10 and 11: These loans are generally referred to as our "substandard - non-accrual" and "doubtful" commercial credits. This rating includes loans to borrowers with weaknesses that make collection of debt in full, on the basis of current facts, conditions and values at best questionable and at worst improbable. All of these loans are placed in non-accrual.

Rating 12: These loans are generally referred to as our "loss" commercial credits. This rating includes loans to borrowers that are deemed incapable of repayment and are charged-off.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The following table summarizes loan ratings by loan class for our commercial loan segment:

	Non-watch 1-6	Watch 7-8	Commercial Substandard Accrual 9	Non-Accrual 10-11	Total
			(In thousands)		
September 30, 2012					
Income producing - real estate	$ 166,740	$ 37,261	$ 2,513	$ 7,742	$ 214,256
Land, land development and construction - real estate	31,129	5,172	2,673	4,598	43,572
Commercial and industrial	294,232	30,032	16,033	7,174	347,471
Total	$ 492,101	$ 72,465	$ 21,219	$ 19,514	$ 605,299
Accrued interest included in total	$ 1,430	$ 240	$ 91	$ -	$ 1,761
December 31, 2011					
Income producing - real estate	$ 201,655	$ 52,438	$ 5,785	$ 13,788	$ 273,666
Land, land development and construction - real estate	33,515	9,421	4,800	6,990	54,726
Commercial and industrial	275,245	27,783	13,935	7,984	324,947
Total	$ 510,415	$ 89,642	$ 24,520	$ 28,762	$ 653,339
Accrued interest included in total	$ 1,677	$ 381	$ 126	$ -	$ 2,184

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

For each of our mortgage and consumer segment classes we generally monitor credit quality based on the credit scores of the borrowers. These credit scores are generally updated at least annually.

The following table summarizes credit scores by loan class for our mortgage and installment loan segments:

	Mortgage (1)				
	1-4 Family	Resort Lending	Home Equity 1st Lien	Home Equity 2nd Lien	Total
			(In thousands)		
September 30, 2012					
800 and above	$ 23,203	$ 19,052	$ 2,586	$ 5,282	$ 50,123
750-799	58,758	64,803	5,871	13,757	143,189
700-749	57,904	46,530	3,476	9,033	116,943
650-699	59,330	23,087	2,347	8,432	93,196
600-649	34,130	10,136	2,578	4,507	51,351
550-599	27,993	6,786	1,326	2,941	39,046
500-549	22,506	2,888	885	2,308	28,587
Under 500	8,961	847	468	668	10,944
Unknown	5,378	577	152	178	6,285
Total	$ 298,163	$ 174,706	$ 19,689	$ 47,106	$ 539,664
Accrued interest included in total	$ 1,392	$ 808	$ 101	$ 256	$ 2,557
December 31, 2011					
800 and above	$ 26,509	$ 17,345	$ 4,062	$ 6,317	$ 54,233
750-799	63,746	76,381	8,058	16,892	165,077
700-749	55,047	53,210	4,280	12,131	124,668
650-699	54,579	21,579	2,854	7,909	86,921
600-649	40,977	12,750	2,485	5,066	61,278
550-599	29,732	10,698	1,547	3,466	45,443
500-549	28,573	3,716	1,615	2,758	36,662
Under 500	12,434	565	539	886	14,424
Unknown	4,082	579	80	174	4,915
Total	$ 315,679	$ 196,823	$ 25,520	$ 55,599	$ 593,621
Accrued interest included in total	$ 1,404	$ 928	$ 123	$ 290	$ 2,745

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

	Home Equity 1st Lien	Home Equity 2nd Lien	Installment(1) Loans not Secured by Real Estate (In thousands)	Other	Total
September 30, 2012					
800 and above	$ 3,900	$ 3,741	$ 19,738	$ 46	$ 27,425
750-799	8,350	11,554	46,222	551	66,677
700-749	5,507	9,231	23,674	711	39,123
650-699	5,813	7,541	14,369	592	28,315
600-649	3,791	4,666	6,685	497	15,639
550-599	3,309	2,489	3,269	170	9,237
500-549	2,164	1,786	2,802	125	6,877
Under 500	710	939	793	24	2,466
Unknown	48	7	2,676	26	2,757
Total	$ 33,592	$ 41,954	$ 120,228	$ 2,742	$ 198,516
Accrued interest included in total	$ 144	$ 160	$ 453	$ 23	$ 780
December 31, 2011					
800 and above	$ 5,466	$ 5,047	$ 18,245	$ 70	$ 28,828
750-799	11,651	16,475	41,501	572	70,199
700-749	6,899	10,693	23,174	883	41,649
650-699	7,144	8,407	15,646	673	31,870
600-649	4,943	5,412	7,599	434	18,388
550-599	3,435	3,221	4,573	270	11,499
500-549	3,021	3,145	3,011	183	9,360
Under 500	1,160	854	1,391	50	3,455
Unknown	83	34	5,037	59	5,213
Total	$ 43,802	$ 53,288	$ 120,177	$ 3,194	$ 220,461
Accrued interest included in total	$ 176	$ 208	$ 489	$ 29	$ 902

(1) Credit scores have been updated within the last twelve months.

Mepco Finance Corporation ("Mepco") is a wholly-owned subsidiary of our Bank that operates a vehicle service contract payment plan business throughout the United States. See Note #14 for more information about Mepco's business. As of September 30, 2012, approximately 91.7% of Mepco's outstanding payment plan receivables relate to programs in which a third party insurer or risk retention group is obligated to pay Mepco the full refund owing upon cancellation of the related service contract (including with respect to both the portion funded to the service contract seller and the portion funded to the administrator). These receivables are shown as "Full Refund" in the table below. Another approximately 8.0% of Mepco's outstanding payment plan receivables as of September 30, 2012, relate to programs in which a third party insurer or risk retention group is obligated to pay Mepco the refund owing upon cancellation only with respect to the unearned portion previously funded by Mepco to the administrator (but not to the service contract seller). These receivables are shown as "Partial Refund" in the table below. The balance of Mepco's outstanding payment plan receivables relate to programs in which there is no insurer or risk retention group that has

any contractual liability to Mepco for any portion of the refund amount. These receivables are shown as “Other” in the table below. For each class of our payment plan receivables we monitor credit ratings of the counterparties as we evaluate the credit quality of this portfolio.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The following table summarizes credit ratings of insurer or risk retention group counterparties by class of payment plan receivable:

	Payment Plan Receivables			
	Full Refund	Partial Refund	Other	Total
	(In thousands)			
September 30, 2012				
AM Best rating				
A +	$ -	$ -	$ 149	$ 149
A	29,211	4,657	-	33,868
A-	18,001	2,802	-	20,803
B +	162	-	-	162
B	-	-	-	-
Not rated	38,488	-	138	38,626
Total	$ 85,862	$ 7,459	$ 287	$ 93,608
December 31, 2011				
AM Best rating				
A +	$ -	$ 118	$ 7	$ 125
A	32,461	165	269	32,895
A-	27,056	10,639	-	37,695
B +	1,390	-	-	1,390
B	-	-	-	-
Not rated	42,762	-	151	42,913
Total	$ 103,669	$ 10,922	$ 427	$ 115,018

Although Mepco has contractual recourse against various counterparties for refunds owing upon cancellation of vehicle service contracts, please see Note #14 below regarding certain risks and difficulties associated with collecting these refunds.

5. Segments

Our reportable segments are based upon legal entities. We currently have two reportable segments: Independent Bank ("IB" or "Bank") and Mepco. These business segments are also differentiated based on the products and services provided. We evaluate performance based principally on net income (loss) of the respective reportable segments.

In the normal course of business, our IB segment provides funding to our Mepco segment through an intercompany line of credit priced at the prime rate of interest as published in the Wall Street Journal. Our IB segment also provides certain administrative services to our Mepco segment which reimburses at an agreed upon rate. These intercompany transactions are eliminated upon consolidation. The only other material intersegment balances and transactions are investments in subsidiaries at the parent entities and cash balances on deposit at our IB segment.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

A summary of selected financial information for our reportable segments as of or for the three-month and nine-month periods ended September 30 follows:

As of or for the three months ended September 30,

	IB	Mepco	Other(1)	Elimination(2)	Total
			(In thousands)		
2012					
Total assets	$ 2,252,476	$ 145,690	$ 178,098	$ (175,432)	$ 2,400,832
Interest income	21,057	3,676	-	-	24,733
Net interest income	19,380	2,806	(735)	-	21,451
Provision for loan losses	270	(19)	-	-	251
Income (loss) before income tax	6,988	405	(923)	(24)	6,446
Net income (loss)	7,125	268	(923)	(24)	6,446
2011					
Total assets	$ 2,116,134	$ 202,034	$ 168,422	$ (169,217)	$ 2,317,373
Interest income	22,913	5,274	-	-	28,187
Net interest income	20,474	3,982	(682)	-	23,774
Provision for loan losses	6,165	6	-	-	6,171
Loss before income tax	(3,594)	(150)	(836)	(24)	(4,604)
Net loss	(3,164)	(96)	(838)	(24)	(4,122)

(1) Includes amounts relating to our parent company and certain insignificant operations.
(2)Includes parent company's investment in subsidiaries and cash balances maintained at subsidiary.

As of or for the nine months ended September 30,

	IB	Mepco	Other(1)	Elimination(2)	Total
			(In thousands)		
2012					
Total assets	$ 2,252,476	$ 145,690	$ 178,098	$ (175,432)	$ 2,400,832
Interest income	64,452	11,232	-	-	75,684
Net interest income	59,085	8,487	(2,191)	-	65,381
Provision for loan losses	6,436	2	-	-	6,438
Income (loss) before income tax	14,945	2,298	(2,889)	(71)	14,283
Net income (loss)	15,726	1,517	(2,889)	(71)	14,283
2011					
Total assets	$ 2,116,134	$ 202,034	$ 168,422	$ (169,217)	$ 2,317,373
Interest income	71,226	16,806	-	-	88,032
Net interest income	61,078	12,556	(2,026	-	71,608

Provision for loan losses	20,986	43	-	-	21,029
Loss before income tax	(9,463)	(1,062)	(1,638)	(71)	(12,234)
Net loss	(9,097)	(678)	(1,640)	(71)	(11,486)

(1)Includes amounts relating to our parent company and certain insignificant operations.
(2)Includes parent company's investment in subsidiaries and cash balances maintained at subsidiary.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

6. Earnings Per Common Share

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
	(In thousands, except per share amounts)			
Net income (loss) applicable to common stock	$5,353	$ (5,165)	$ 11,042	$ (14,588)
Convertible preferred stock dividends	1,093	-	3,241	-
Net income (loss) applicable to common stock for calculation of diluted earnings per share(1) (2)	$6,446	$ (5,165)	$ 14,283	$ (14,588)
Weighted average shares outstanding	8,779	8,401	8,637	8,209
Effect of convertible preferred stock	30,523	42,452	30,523	42,452
Restricted stock units	221	140	167	116
Stock units for deferred compensation plan for non-employee directors	81	7	54	7
Effect of stock options	9	-	-	-
Weighted average shares outstanding for calculation of diluted earnings per share(1)	39,613	51,000	39,381	50,784
Net income (loss) per common share				
Basic	$.61	$ (.61)	$ 1.28	$ (1.78)
Diluted(2)	.16	(.61)	.36	(1.78)

(1) For any period in which a loss is recorded, dividends on convertible preferred stock are not added back in the diluted per share calculation. For any period in which a loss is recorded, the assumed conversion of convertible preferred stock, assumed exercise of common stock warrants, assumed exercise of stock options, restricted stock units and stock units for a deferred compensation plan for non-employee directors would have an anti-dilutive impact on the loss per share and thus are ignored in the diluted per share calculation.
(2) Basic income (loss) per share includes weighted average common shares outstanding during the period and participating share awards.

Weighted average stock options outstanding that were not included in weighted average shares outstanding for calculation of diluted earnings per share because they were anti-dilutive totaled 0.1 million and 0.2 million for the three-month periods ended September 30, 2012 and 2011, respectively and totaled 0.2 million and 0.1 million for the nine-month periods ended September 30, 2012 and 2011, respectively. The warrant to purchase 346,154 shares of our common stock (see Note #15) was not included in weighted average shares outstanding for calculation of diluted earnings per share in all periods in 2012 and 2011 as it was anti-dilutive.

7. Derivative Financial Instruments

We are required to record derivatives on our Condensed Consolidated Statements of Financial Condition as assets and liabilities measured at their fair value. The accounting for increases and decreases in the value of derivatives depends upon the use of derivatives and whether the derivatives qualify for hedge accounting.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Our derivative financial instruments according to the type of hedge in which they are designated follows:

	September 30, 2012		
	Notional Amount	Average Maturity (years)	Fair Value
	(Dollars in thousands)		
Cash Flow Hedges - Pay fixed interest-rate swap agreements	$10,000	2.3	$(835)
No hedge designation			
Mandatory commitments to sell mortgage loans	$62,883	0.1	$2,787
Rate-lock mortgage loan commitments	101,482	0.1	(1,475)
Amended Warrant	2,504	6.2	(385)
Total	$166,869	0.2	$927

We have established management objectives and strategies that include interest-rate risk parameters for maximum fluctuations in net interest income and market value of portfolio equity. We monitor our interest rate risk position via simulation modeling reports. The goal of our asset/liability management efforts is to maintain profitable financial leverage within established risk parameters.

We use variable-rate and short-term fixed-rate (less than 12 months) debt obligations to fund a portion of our balance sheet, which exposes us to variability in interest rates. To meet our objectives, we may periodically enter into derivative financial instruments to mitigate exposure to fluctuations in cash flows resulting from changes in interest rates (“Cash Flow Hedges”). Cash Flow Hedges currently include certain pay-fixed interest-rate swaps. Pay-fixed interest-rate swaps convert the variable-rate cash flows on debt obligations to fixed-rates.

We record the fair value of Cash Flow Hedges in accrued income and other assets and accrued expenses and other liabilities. On an ongoing basis, we adjust our Condensed Consolidated Statements of Financial Condition to reflect the then current fair value of Cash Flow Hedges. The related gains or losses are reported in other comprehensive income or loss and are subsequently reclassified into earnings, as a yield adjustment in the same period in which the related interest on the hedged items (primarily variable-rate debt obligations) affect earnings. It is anticipated that approximately $0.4 million, of unrealized losses on Cash Flow Hedges at September 30, 2012 will be reclassified to earnings over the next twelve months. To the extent that the Cash Flow Hedges are not effective, the ineffective portion of the Cash Flow Hedges is immediately recognized as interest expense. The maximum term of any Cash Flow Hedge at September 30, 2012 is 2.3 years.

Certain financial derivative instruments have not been designated as hedges. The fair value of these derivative financial instruments has been recorded on our Condensed Consolidated Statements of Financial Condition and are adjusted on an ongoing basis to reflect their then current fair value. The changes in fair value of derivative financial instruments not designated as hedges are recognized in earnings.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

In the ordinary course of business, we enter into rate-lock mortgage loan commitments with customers ("Rate Lock Commitments"). These commitments expose us to interest rate risk. We also enter into mandatory commitments to sell mortgage loans ("Mandatory Commitments") to reduce the impact of price fluctuations of mortgage loans held for sale and Rate Lock Commitments. Mandatory Commitments help protect our loan sale profit margin from fluctuations in interest rates. The changes in the fair value of Rate Lock Commitments and Mandatory Commitments are recognized currently as part of net gains on mortgage loans. We obtain market prices on Mandatory Commitments and Rate Lock Commitments. Net gains on mortgage loans, as well as net income (loss) may be more volatile as a result of these derivative instruments, which are not designated as hedges.

During 2010, we entered into an amended and restated warrant with the U.S. Department of the Treasury ("UST") that would allow them to purchase our common stock at a fixed price (see Note #15). Because of certain anti-dilution features included in the Amended Warrant (as defined in Note #15), it is not considered to be indexed to our common stock and is therefore accounted for as a derivative instrument and recorded as a liability. Any change in value of the Amended Warrant is recorded in other income in our Condensed Consolidated Statements of Operations.

The following tables illustrate the impact that the derivative financial instruments discussed above have on individual line items in the Condensed Consolidated Statements of Financial Condition for the periods presented:

Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	September 30, 2012		December 31, 2011		September 30, 2012		December 31, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	(In thousands)							
Derivatives designated as hedging instruments								
Pay-fixed interest rate swap agreements					Other liabilities	$835	Other liabilities	$1,103
Total						835		1,103
Derivatives not designated as hedging instruments								
Rate-lock mortgage loan commitments	Other assets	$2,787	Other assets	$857				
Mandatory commitments to sell mortgage	Other assets	-		-		1,475	Other liabilities	606

loans

Amended Warrant	-	-	Other liabilities	385	Other liabilities	174
Total	2,787	857		1,860		780
Total derivatives	$2,787	$857		$ 2,695		$1,883

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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The effect of derivative financial instruments on the Condensed Consolidated Statements of Operations follows:

	Three Month Periods Ended September 30,							
	Gain (Loss) Recognized in Other Comprehensive Income (Loss) (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income (1)	Gain (Loss) Recognized in Income	
	2012	2011		2012	2011		2012	2011
	(In thousands)							
Cash Flow Hedges								
Pay-fixed interest rate swap agreements	$ (54)	$ (215)	Interest expense	$ (237)	$ (345)		$ -	$ 3
Interest-rate cap agreements	-	-	Interest expense	-	-		-	-
Total	$ (54)	$ (215)		$ (237)	$ (345)		$ -	$ 3
No hedge designation								
Rate-lock mortgage loan commitments						Net mortgage loan gains	$ 804	$ 369
Mandatory commitments to sell mortgage loans						Net mortgage loan gains	(779)	(339)
Amended warrant						(Increase) decrease in fair value of U.S. Treasury warrant	(32)	29
Total							$ (7)	$ 59

(1)For cash flow hedges, this location and amount refers to the ineffective portion.

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	Nine Month Periods Ended September 30,							
	Gain (Loss) Recognized in Other Comprehensive Income (Loss) (Effective Portion)		Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Effective Portion)		Location of Gain (Loss) Recognized in Income (1)	Gain (Loss) Recognized in Income	
	2012	2011		2012	2011		2012	2011
	(In thousands)							
Cash Flow Hedges								
Pay-fixed interest rate swap agreements	$ (129)	$ (508)	Interest expense	$ (833)	$ (1,102)		$ -	$ -
Interest-rate cap agreements	-	30	Interest expense	-	(15)		-	-
Total	$ (129)	$ (478)		$ (833)	$ (1,117)		$ -	$ -
No hedge designation								
Rate-lock mortgage loan commitments						Net mortgage loan gains	$ 1,930	$ 468
Mandatory commitments to sell mortgage loans						Net mortgage loan gains	(869)	(1,635)
Amended warrant						(Increase) decrease in fair value of U.S. Treasury warrant	(211)	1,025
Total							$ 850	$ (142)

(1)For cash flow hedges, this location and amount refers to the ineffective portion.

8. Intangible Assets

Other intangible assets, net of amortization, were comprised of the following at September 30, 2012 and December 31, 2011:

	September 30, 2012		December 31, 2011	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(In thousands)			
Amortized other intangible assets - core deposits	$31,326	$ 24,533	$ 31,326	$ 23,717

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Amortization of other intangibles has been estimated through 2017 and thereafter in the following table.

		(In thousands)
Three months ended December 31, 2012	$	272
Year ending December 31:		
2013		1,078
2014		801
2015		613
2016		613
2017 and thereafter		3,416
Total	$	6,793

9. Share Based Compensation

We maintain share based payment plans that include a non-employee director stock purchase plan and a long-term incentive plan that permits the issuance of share based compensation, including stock options and non-vested share awards. The long-term incentive plan, which is shareholder approved, permits the grant of additional share based awards for up to 0.2 million shares of common stock as of September 30, 2012. The non-employee director stock purchase plan permits the grant of additional share based payments for up to 0.3 million shares of common stock as of September 30, 2012. Share based awards and payments are measured at fair value at the date of grant and are expensed over the requisite service period. Common shares issued upon exercise of stock options come from currently authorized but unissued shares.

During the first quarter of 2012 our president's annual salary was increased by $0.03 million, effective January 1, 2012. One half of this increase is currently being paid in the form of common stock (also referred to as "salary stock"). During the first quarter of 2011, pursuant to a management transition plan, our chief executive officer's annual salary was increased by $0.2 million effective January 1, 2011. This increase is currently being paid entirely in the form of salary stock. These shares are issued each pay period and vest immediately.

During the third quarter of 2012, we issued 0.22 million restricted stock units to six of our executive officers. These restricted stock units do not vest for a minimum of three years and until we repay in full our obligations related to the Troubled Asset Relief Program ("TARP"). During the first quarter of 2011, we issued 0.14 million restricted stock units to five of our executive officers. These restricted stock units do not vest for a minimum of two years and until we repay in full our obligations related to the TARP.

During the third quarter of 2012, pursuant to our performance-based compensation plans we granted 0.1 million stock options to certain officers, none of whom is a named executive officer. The stock options have an exercise price equal to the market value on the date of grant, vest ratably over a three year period and expire 10 years from date of grant. We use the Black Scholes option pricing model to measure compensation cost for stock options. We also estimate expected forfeitures over the vesting period.

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Beginning in the second quarter of 2011 our directors elected to receive their quarterly cash retainer fees in the form of common stock currently (or on a deferred basis pursuant to a deferred compensation and stock purchase plan). Shares equal in value to each director's quarterly cash retainer are issued each quarter and vest immediately. We have issued 0.17 million shares and 0.08 million shares to directors during the first nine months of 2012 and 2011, respectively and expensed their value during those same periods.

Total compensation expense recognized for stock option grants, restricted stock grants, restricted stock unit grants and salary stock was $0.2 million and $0.3 million during the three and nine month periods ended September 30, 2012, and was $0.3 million and $0.7 million during the same periods in 2011. The corresponding tax benefit relating to this expense was zero for the three and nine month periods ended September 30, 2012 and 2011, respectively. Total expense recognized for non-employee director share based payments was $0.1 million in both three month periods ended September 30, 2012 and 2011 and $0.3 million and $0.2 million in the nine month periods ended September 30, 2012 and 2011, respectively.

At September 30, 2012, the total expected compensation cost related to non-vested stock options, restricted stock and restricted stock unit awards not yet recognized was $1.4 million. The weighted-average period over which this amount will be recognized is 2.8 years.

A summary of outstanding stock option grants and transactions follows:

	Nine-months ended September 30, 2012			
	Number of Shares	Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregated Intrinsic Value (in thousands)
Outstanding at January 1, 2012	180,862	$ 7.98		
Granted	113,400	2.70		
Exercised	(1,401)	1.92		
Forfeited	(11,666)	1.92		
Expired	(5,495)	90.66		
Outstanding at September 30, 2012	275,700	$ 4.45	8.67	$ 100
Vested and expected to vest at September 30, 2012	253,972	$ 4.62	8.60	$ 94
Exercisable at September 30, 2012	77,881	$ 9.73	7.04	$ 32

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A summary of non-vested restricted stock and stock units and transactions follows:

	2012	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2012	165,045	$ 17.90
Granted	221,147	2.78
Vested	(4,496)	166.90
Forfeited	(522)	93.14
Outstanding at September 30, 2012	381,174	$ 7.27

A summary of the weighted-average assumptions used in the Black-Scholes option pricing model for grants of stock options during 2012 follows:

Expected dividend yield	0.74 %
Risk-free interest rate	0.88
Expected life (in years)	6.00
Expected volatility	100.00 %
Per share weighted-average fair value	$2.02

The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life was obtained using a simplified method that, in general, averaged the vesting term and original contractual term of the stock option. This method was used as relevant historical data of actual exercise activity was not available. The expected volatility was based on historical volatility of our common stock.

The following summarizes certain information regarding options exercised during the three- and nine-month periods ended September 30:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Intrinsic value	$ 1	$ -	$ 1	$ -
Cash proceeds received	$ 3	$ -	$ 3	$ -
Tax benefit realized	$ -	$ -	$ -	$ -

10. Income Tax

At both September 30, 2012 and December 31, 2011, we had approximately $2.1 million of gross unrecognized tax benefits. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease during the balance of 2012.

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As a result of being in a net operating loss carryforward position, we have established a deferred tax asset valuation allowance of $69.2 million and $75.2 million as of September 30, 2012 and December 31, 2011, respectively against all of our net deferred tax assets. Accordingly, we are not recognizing much income tax expense (benefit) related to any income or loss before income tax. The income tax expense (benefit) was zero for the three and nine month periods ended September 30, 2012. Income tax (benefit) was $(0.48) million and $(0.75) million for the three and nine month periods ended September 30, 2011, respectively. The benefit recognized during these periods was primarily the result of current period adjustments to other comprehensive income ("OCI"), net of state income tax expense and adjustments to the deferred tax asset valuation allowance. In addition, the three- and nine-month periods in 2011 included the benefit of a favorable tax adjustment ($0.09 million) relating to an Internal Revenue Service review and interest ($0.13 million) relating to a refund.

Generally, the amount of income tax expense or benefit allocated to operations is determined without regard to the tax effects of other categories of income or loss, such as other comprehensive income (loss). However, an exception to the general rule is provided when, in the presence of a valuation allowance against deferred tax assets, there is a pretax loss from operations and pretax income from other categories in the current period. In such instances, income from other categories must offset the current loss from operations, the tax benefit of such offset being reflected in operations. For the three and nine month periods ended September 30, 2011 this resulted in an income tax (benefit) of $(0.23) million and $(0.49) million, respectively.

11. Regulatory Matters

Capital guidelines adopted by Federal and State regulatory agencies and restrictions imposed by law limit the amount of cash dividends our Bank can pay to us. Under these guidelines, the amount of dividends that may be paid in any calendar year is limited to the Bank's current year's net profits, combined with the retained net profits of the preceding two years. It is not our intent to have dividends paid in amounts which would reduce the capital of our Bank to levels below those which we consider prudent and in accordance with guidelines of regulatory authorities.

In December 2009, the Board of Directors of Independent Bank Corporation adopted resolutions (as subsequently amended) that impose the following restrictions:

We will not pay dividends on our outstanding common stock or the outstanding preferred stock held by the UST and we will not pay distributions on our outstanding trust preferred securities without, in each case, the prior written approval of the Federal Reserve Board ("FRB") and the Michigan Office of Financial and Insurance Regulation ("OFIR");

We will not incur or guarantee any additional indebtedness without the prior approval of the FRB;

We will not repurchase or redeem any of our common stock without the prior approval of the FRB; and

We will not rescind or materially modify any of these limitations without notice to the FRB and the OFIR.

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In December 2009, the Board of Directors of Independent Bank adopted resolutions (as subsequently amended) designed to enhance certain aspects of the Bank's performance and, most importantly, to improve the Bank's capital position. These resolutions require the following:

- The adoption by the Bank of a capital restoration plan designed to help the Bank achieve the minimum capital ratios established by the Bank's Board of Directors as described below;
- The enhancement of the Bank's documentation of the rationale for discounts applied to collateral valuations on impaired loans and improved support for the identification, tracking, and reporting of loans classified as TDR's;
- The adoption of certain changes and enhancements to our liquidity monitoring and contingency planning and our interest rate risk management practices;
- Additional reporting to the Bank's Board of Directors regarding initiatives and plans pursued by management to improve the Bank's risk management practices;
- Prior approval of the FRB and the OFIR for any dividends or distributions to be paid by the Bank to Independent Bank Corporation; and
- Notice to the FRB and the OFIR of any rescission of or material modification to any of these resolutions.

The substance of all of the resolutions described above was developed in conjunction with discussions held with the FRB and the OFIR. Based on those discussions, we acted proactively to adopt the resolutions described above to address those areas of the Bank's financial condition and operations that we believed most required our focus at that time.

On October 25, 2011, the respective Boards of Directors of the Company and the Bank entered into a Memorandum of Understanding ("MOU") with the FRB and OFIR. The MOU largely duplicates certain of the provisions in the Board resolutions described above, but also has the following specific requirements:

- Submission of a joint revised capital plan (the "Capital Plan") by November 30, 2011 to maintain sufficient capital at the Company on a consolidated basis and at the Bank on a stand-alone basis;
- Submission of quarterly progress reports regarding disposition plans for any assets in excess of $1.0 million that are in ORE, are 90 days or more past due, are on our "watch list", or were adversely classified in our most recent examination;
- Enhanced reporting and monitoring at Mepco regarding risk management and the internal classification of assets; and
- Enhanced interest rate risk modeling practices.

We submitted our Capital Plan on a timely basis and believe that we are generally in compliance with the provisions of the MOU, however, we must still execute on certain strategies outlined in our Capital Plan.

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We are also subject to various regulatory capital requirements. The prompt corrective action regulations establish quantitative measures to ensure capital adequacy and require minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly discretionary, actions by regulators that could have a material effect on our consolidated financial statements. Under capital adequacy guidelines, we must meet specific capital requirements that involve quantitative measures as well as qualitative judgments by the regulators. The most recent regulatory filings as of September 30, 2012 and December 31, 2011 categorized our Bank as well capitalized. Management is not aware of any conditions or events that would have changed the most recent Federal Deposit Insurance Corporation ("FDIC") categorization.

Our actual capital amounts and ratios follow:

	Actual			Minimum for Adequately Capitalized Institutions			Minimum for Well-Capitalized Institutions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
				(Dollars in thousands)					
September 30, 2012									
Total capital to risk-weighted assets									
Consolidated	$189,627	12.98	%	$116,898	8.00	%	NA	NA	
Independent Bank	192,779	13.22		116,682	8.00		$145,853	10.00	%
Tier 1 capital to risk-weighted assets									
Consolidated	$165,638	11.34	%	$58,449	4.00	%	NA	NA	
Independent Bank	174,171	11.94		58,341	4.00		$87,512	6.00	%
Tier 1 capital to average assets									
Consolidated	$165,638	6.92	%	$95,732	4.00	%	NA	NA	
Independent Bank	174,171	7.29		95,626	4.00		$119,533	5.00	%
December 31, 2011									
Total capital to risk-weighted assets									
Consolidated	$174,547	11.31	%	$123,470	8.00	%	NA	NA	
Independent Bank	175,868	11.41		123,254	8.00		$154,068	10.00	%
Tier 1 capital to risk-weighted assets									
Consolidated	$144,265	9.35	%	$61,735	4.00	%	NA	NA	
Independent Bank	156,104	10.13		61,627	4.00		$92,441	6.00	%
Tier 1 capital to average assets									
Consolidated	$144,265	6.25	%	$92,338	4.00	%	NA	NA	

Independent Bank	156,104	6.77	92,268	4.00	$115,335	5.00	%

NA - Not applicable

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The components of our regulatory capital are as follows:

	Consolidated		Independent Bank	
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
	(In thousands)			
Total shareholders' equity	$ 121,528	$ 102,627	$ 173,283	$ 152,987
Add (deduct)				
Qualifying trust preferred securities	43,320	38,183	-	-
Accumulated other comprehensive loss	8,432	11,921	8,530	11,583
Intangible assets	(6,793)	(7,609)	(6,793)	(7,609)
Disallowed capitalized mortgage loan servicing rights	(849)	(857)	(849)	(857)
Tier 1 capital	165,638	144,265	174,171	156,104
Qualifying trust preferred securities	5,348	10,485	-	-
Allowance for loan losses and allowance for unfunded lending commitments limited to 1.25% of total risk-weighted assets	18,641	19,797	18,608	19,764
Total risk-based capital	$ 189,627	$ 174,547	$ 192,779	$ 175,868

In November, 2011, our Board adopted the Capital Plan and submitted such Capital Plan to the FRB and the OFIR. The Capital Plan was updated in February, 2012. The FRB and OFIR have accepted such Capital Plan, assuming the execution of certain strategies and the attainment of the required Tier 1 Capital to Average Total Assets Ratio of 8%.

The primary objective of our Capital Plan is to achieve and thereafter maintain the minimum capital ratios required by the Board resolutions adopted in December 2009 (as subsequently amended). The minimum capital ratios established by our Board are higher than the ratios required in order to be considered “well-capitalized” under federal standards. The Board imposed these higher ratios in order to ensure that we have sufficient capital to withstand potential continuing losses based on our prevailing elevated level of non-performing assets and given certain other risks and uncertainties we face. As of September 30, 2012, our Bank continued to meet the requirements to be considered “well-capitalized” under federal regulatory standards and met one of the minimum capital ratio goals established by our Board.

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Set forth below are the actual capital ratios of our Bank as of September 30, 2012, the minimum capital ratios imposed by the Board resolutions, and the minimum ratios necessary to be considered "well-capitalized" under federal regulatory standards:

	Independent Bank Actual as of September 30, 2012	Minimum Ratios Established by our Board	Minimum Ratio Required to be Well-Capitalized
Total Capital to Risk-Weighted Assets	13.22 %	11.00 %	10.00 %
Tier 1 Capital to Average Total Assets	7.29	8.00	5.00

If we are unable to achieve both minimum capital ratios set forth in our Capital Plan it may adversely affect our business and financial condition. An inability to improve our capital position could make it difficult for us to withstand future losses. In addition, we believe that if our financial condition and performance deteriorate, we may not be able to remain well-capitalized under federal regulatory standards. In that case, our primary bank regulators may impose additional regulatory restrictions and requirements on us. If we fail to remain well-capitalized under federal regulatory standards, we will be prohibited from accepting or renewing brokered certificates of deposit without the prior consent of the FDIC, which would likely have an adverse impact on our business and financial condition. If our regulators take more formal enforcement action against us, it would likely increase our expenses and could limit our business operations. There could be other expenses associated with a deterioration of our capital, such as increased deposit insurance premiums payable to the FDIC. At the present time, based on our current forecasts and expectations, we believe that our Bank can remain above "well-capitalized" for regulatory purposes for the foreseeable future, even without additional capital, due to our projected further decline in total assets (principally loans), our improved performance in 2012 and the impact of a pending branch sale (see Note #16).

12. Fair Value Disclosures

FASB ASC topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 instruments include securities traded on active exchange markets, such as the New York Stock Exchange, as well as U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. Level 2 instruments include securities traded in less active dealer or broker

markets.

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Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

We used the following methods and significant assumptions to estimate fair value:

Securities: Where quoted market prices are available in an active market, securities (trading or available for sale) are classified as Level 1 of the valuation hierarchy. Level 1 securities include certain preferred stocks included in our trading portfolio for which there are quoted prices in active markets. If quoted market prices are not available for the specific security, then fair values are estimated by (1) using quoted market prices of securities with similar characteristics, (2) matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark quoted prices, or (3) a discounted cash flow analysis whose significant fair value inputs can generally be verified and do not typically involve judgment by management. These securities are classified as Level 2 of the valuation hierarchy and include agency and private label residential mortgage-backed securities, municipal securities and trust preferred securities.

Loans held for sale: The fair value of mortgage loans held for sale is based on mortgage backed security pricing for comparable assets (recurring Level 2). The fair value of loans held for sale relating to branch sale is based on a discount provided for in the branch sale agreement (non-recurring Level 2).

Impaired loans with specific loss allocations based on collateral value: From time to time, certain loans are considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. We measure our investment in an impaired loan based on one of three methods: the loan's observable market price, the fair value of the collateral or the present value of expected future cash flows discounted at the loan's effective interest rate. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2012 and December 31, 2011, all of our total impaired loans were evaluated based on either the fair value of the collateral or the present value of expected future cash flows discounted at the loan's effective interest rate. When the fair value of the collateral is based on an appraised value or when an appraised value is not available we record the impaired loan as nonrecurring Level 3. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and thus will typically result in a Level 3 classification of the inputs for determining fair value.

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Other real estate: At the time of acquisition, other real estate is recorded at fair value, less estimated costs to sell, which becomes the property's new basis. Subsequent write-downs to reflect declines in value since the time of acquisition may occur from time to time and are recorded in other expense in the Condensed Consolidated Statements of Operations. The fair value of the property used at and subsequent to the time of acquisition is typically determined by a third party appraisal of the property. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments can be significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by us. Once received, an independent third party (for commercial properties over $0.25 million) or a member of our special assets group (for commercial properties under $0.25 million and retail properties) reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, we compare the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment, if any, should be made to the appraisal value to arrive at fair value. For commercial properties we typically do not discount an appraisal while for retail properties we generally discount the value by 5%. In addition, we will adjust the appraised values for expected liquidation costs including sales commissions and transfer taxes.

Capitalized mortgage loan servicing rights: The fair value of capitalized mortgage loan servicing rights is based on a valuation model used by an independent third party that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. Since the secondary servicing market has not been active since the later part of 2009, model assumptions are generally unobservable and are based upon the best information available including data relating to our own servicing portfolio, reviews of mortgage servicing assumption and valuation surveys and input from various mortgage servicers and, therefore, are recorded as nonrecurring Level 3. At September 30, 2012 these assumptions included a weighted average ("WA") discount rate of 11.0%, WA cost to service of $84, WA ancillary income of $44 and WA float rate of 0.76%. Management evaluates the third party valuation for reasonableness each quarter as part of our financial reporting control processes.

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Derivatives: The fair value of interest rate swap agreements, in general, is determined using a discounted cash flow model whose significant fair value inputs can generally be verified and do not typically involve judgment by management (recurring Level 2). The fair value of the Amended Warrant at September 30, 2012 was estimated based on an internal update of an independent third party analysis that was performed at March 31, 2012 (the December 31, 2011 fair value was also based on an independent valuation performed at that date). Nearly all key variables remained consistent between March 31, 2012 (the last date a third party valuation was performed) and September 30, 2012. The internal update primarily focused on the change in our stock price during the second and third quarters of 2012, which was not significant. The third party valuation uses a simulation analysis which considers potential outcomes for a large number of independent scenarios regarding the future prices of our common stock. The simulation analysis relies on a binomial lattice model, a standard technique usually applied to the valuation of stock options. The binomial lattice maps out possible price paths of our common stock, the underlying asset of the Amended Warrant. The simulation is based on a 500-step lattice covering the term of the Amended Warrant. The binomial lattice requires specification of 14 variables, of which several are unobservable in the market including probability of a non-permitted capital raise (1.0% at September 30, 2012 and December 31, 2011), expected discount to stock price in an equity raise (10%), dollar amount of expected capital raise ($100 million) and expected time of equity raise (April, 2013 at September 30, 2012 and December 31, 2011). As a result of these unobservable inputs, the resulting fair value of the Amended Warrant is classified as Level 3 pricing. Changes in these variables would have an impact on the fair value of the Amended Warrant. If the probability of a non-permitted capital raise increased to 2.5%, 5.0% or 10.0%, the value of the Amended Warrant is estimated to increase to $0.43 million, $0.48 million and $0.61 million, respectively.

Property and equipment held for sale: The fair value of property and equipment held for sale relating to the branch sale was determined based upon a value agreed upon in the branch sale agreement (non-recurring Level 2) and property and equipment held for sale relating to our branch consolidation was based on recent offers (non-recurring Level 2) and appraisals (non-recurring Level 3).

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Assets and liabilities measured at fair value, including financial assets for which we have elected the fair value option, were as follows:

		Fair Value Measurements Using		
	Fair Value Measure-ments	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
	(In thousands)			
September 30, 2012:				
Measured at Fair Value on a Recurring Basis:				
Assets				
Trading securities	$38	$38	$-	$-
Securities available for sale				
U.S. agency	45,637	-	45,637	-
U.S. agency residential mortgage-backed	132,620	-	132,620	-
Private label residential mortgage-backed	8,302	-	8,302	-
Obligations of states and political subdivisions	40,361	-	40,361	-
Trust preferred	3,266	-	3,266	-
Loans held for sale	41,969	-	41,969	-
Derivatives (1)	2,787	-	2,787	-
Liabilities				
Derivatives (2)	2,695	-	2,310	385
Measured at Fair Value on a Non-recurring basis:				
Assets				
Capitalized mortgage loan servicing rights (3)	8,855	-	-	8,855
Impaired loans (4)				
Commercial				
Income producing - real estate	4,862	-	-	4,862
Land, land development &construction-real estate	3,074	-	-	3,074
Commercial and industrial	7,622	-	-	7,622
Mortgage				
1-4 Family	2,822	-	-	2,822
Resort Lending	239	-	-	239
Other real estate (5)				
Commercial				
Income producing - real estate	2,157	-	-	2,157
Land, land development &construction-real estate	5,193	-	-	5,193
Mortgage				
1-4 Family	591	-	-	591
Resort Lending	4,636	-	-	4,636

Installment				
Home equity installment - 1st lien	104	-	-	104
Loans held for sale relating to branch sale	52,280	-	52,280	-
Property and equipment held for sale	10,148	-	9,825	323

(1) Included in accrued income and other assets
(2) Included in accrued expenses and other liabilities
(3) Only includes servicing rights that are carried at fair value due to recognition of a valuation allowance.
(4) Only includes impaired loans with specific loss allocations based on collateral value.
(5) Only includes other real estate with subsequent write downs to fair value.

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		Fair Value Measurements Using		
	Fair Value Measure-ments	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
	(In thousands)			
December 31, 2011:				
Measured at Fair Value on a Recurring Basis:				
Assets				
Trading securities	$77	$77	$-	$-
Securities available for sale				
U.S. agency	25,017	-	25,017	-
U.S. agency residential mortgage-backed	94,206	-	94,206	-
Private label residential mortgage-backed	8,268	-	8,268	-
Obligations of states and political subdivisions	27,317	-	27,317	-
Trust preferred	2,636	-	2,636	-
Loans held for sale	44,801	-	44,801	-
Derivatives (1)	857	-	857	-
Liabilities				
Derivatives (2)	1,883	-	1,709	174
Measured at Fair Value on a Non-recurring basis:				
Assets				
Capitalized mortgage loan servicing rights (3)	11,004	-	-	11,004
Impaired loans (4)				
Commercial				
Income producing - real estate	8,022	-	-	8,022
Land, land development &construction-real estate	5,702	-	-	5,702
Commercial and industrial	5,613	-	-	5,613
Mortgage				
1-4 Family	3,263	-	-	3,263
Resort Lending	1,064	-	-	1,064
Other real estate (5)				
Commercial				
Income producing - real estate	1,388	-	-	1,388
Land, land development &construction-real estate	7,512	-	-	7,512
Commercial and industrial	497	-	-	497
Mortgage				
1-4 Family	2,079	-	-	2,079
Resort Lending	5,297	-	-	5,297
Home equity line of credit - 1st lien	53	-	-	53
Installment				

Home equity installment - 1st lien	100	-	-	100

(1) Included in accrued income and other assets
(2) Included in accrued expenses and other liabilities
(3) Only includes servicing rights that are carried at fair value due to recognition of a valuation allowance.
(4) Only includes impaired loans with specific loss allocations based on collateral value.
(5) Only includes other real estate with subsequent write downs to fair value.

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There were no transfers between Level 1 and Level 2 during the nine months ended September 30, 2012 and 2011.

Changes in fair values for financial assets which we have elected the fair value option for the periods presented were as follows:

	Changes in Fair Values for the Nine-Month Periods Ended September 30 for Items Measured at Fair Value Pursuant to Election of the Fair Value Option					
	2012			2011		
	Net Gains (Losses) on Assets		Total Change in Fair Values Included in Current Period Earnings	Net Gains (Losses) on Assets		Total Change in Fair Values Included in Current Period Earnings
	Securities	Loans		Securities	Loans	
	(In thousands)					
Trading securities	$(39)	$ -	$ (39)	$ 67	$ -	$ 67
Loans held for sale	-	587	587	-	807	807

For those items measured at fair value pursuant to our election of the fair value option, interest income is recorded within the Condensed Consolidated Statements of Operations based on the contractual amount of interest income earned on these financial assets and dividend income is recorded based on cash dividends.

The following represent impairment charges recognized during the three and nine month periods ended September 30, 2012 and 2011 relating to assets measured at fair value on a non-recurring basis:

- Capitalized mortgage loan servicing rights, whose individual strata are measured at fair value, had a carrying amount of $8.9 million which is net of a valuation allowance of $7.2 million at September 30, 2012 and had a carrying amount of $11.0 million which is net of a valuation allowance of $6.5 million at December 31, 2011. A recovery (charge) of $(0.4) million and $(0.6) million was included in our results of operations for the three and nine month periods ended September 30, 2012, respectively and $(3.1) million and $(3.2) million during the same periods in 2011.
- Loans which are measured for impairment using the fair value of collateral for collateral dependent loans, had a carrying amount of $26.4 million, with a valuation allowance of $7.8 million at September 30, 2012 and had a carrying amount of $33.9 million, with a valuation allowance of $10.3 million at December 31, 2011. An additional provision for loan losses relating to impaired loans of $0.3 million and $1.9 million was included in our results of operations for the three and nine month periods ended September 30, 2012, respectively and $2.7 million and $6.6 million during the same periods in 2011.
- Other real estate, which is measured using the fair value of the property, had a carrying amount of $12.7 million which is net of a valuation allowance of $10.0 million at September 30, 2012 and a carrying amount of $16.9 million which is net of a valuation allowance of $14.7 million at December 31, 2011. An additional charge relating

to ORE measured at fair value of $1.1 million and $1.5 million was included in our results of operations during the three and nine month periods ended September 30, 2012, respectively and $2.1 million and $4.1 million during the same periods in 2011.

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- Property and equipment held for sale, which is measured using the fair value of the assets, had a carrying amount of $10.1 million, which is net of a valuation allowance of $3.3 million at September 30, 2012. A charge relating to property and equipment measured at fair value of $0.9 million was included in our results of operations during the three and nine month periods ended September 30, 2012. There were no such balances at December 31, 2011 or charges during the three and nine month periods ended September 30, 2011.

A reconciliation for all liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30 follows:

	(Liability) Amended Warrant			
	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Beginning balance	$(353)	$(315)	$(174)	$(1,311)
Total gains (losses) realized and unrealized:				
Included in results of operations	(32)	29	(211)	1,025
Included in other comprehensive income	-	-	-	-
Purchases, issuances, settlements, maturities and calls	-	-	-	-
Transfers in and/or out of Level 3	-	-	-	-
Ending balance	$(385)	$(286)	$(385)	$(286)
Amount of total gains (losses) for the period included in earnings attributable to the change in unrealized gains (losses) relating to assets and liabilities still held at September 30	$(32)	$29	$(211)	$1,025

During 2010, we entered into an amended and restated warrant with the UST that would allow them to purchase our common stock at a fixed price (see Note #15). Because of certain anti-dilution features included in the Amended Warrant, it is not considered to be indexed to our common stock and is therefore accounted for as a derivative instrument (see Note #7). Any change in value of this warrant is recorded in other income in our Condensed Consolidated Statements of Operations.

The following table reflects the difference between the aggregate fair value and the aggregate remaining contractual principal balance outstanding for loans held for sale for which the fair value option has been elected for the periods presented.

	Aggregate Fair Value	Difference	Contractual Principal
		(In thousands)	
Loans held for sale			
September 30, 2012	$41,969	$1,990	$39,979
December 31, 2011	44,801	1,403	43,398

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13. Fair Values of Financial Instruments

Most of our assets and liabilities are considered financial instruments. Many of these financial instruments lack an available trading market and it is our general practice and intent to hold the majority of our financial instruments to maturity. Significant estimates and assumptions were used to determine the fair value of financial instruments. These estimates are subjective in nature, involving uncertainties and matters of judgment, and therefore, fair values cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Estimated fair values have been determined using available data and methodologies that are considered suitable for each category of financial instrument. For instruments with adjustable-interest rates which reprice frequently and without significant credit risk, it is presumed that estimated fair values approximate the recorded book balances.

Cash and due from banks and interest bearing deposits: The recorded book balance of cash and due from banks and interest bearing deposits approximate fair value and are classified as Level 1.

Securities: Financial instrument assets actively traded in a secondary market have been valued using quoted market prices. Trading securities are classified as Level 1 while securities available for sale are classified as Level 2 as described in Note #12.

Federal Home Loan Bank and Federal Reserve Bank Stock: It is not practicable to determine the fair value of FHLB and FRB Stock due to restrictions placed on transferability.

Net loans and loans held for sale: The fair value of loans is calculated by discounting estimated future cash flows using estimated market discount rates that reflect credit and interest-rate risk inherent in the loans resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described in Note #12. Loans held for sale are classified as Level 2 as described in Note #12.

Accrued interest receivable and payable: The recorded book balance of accrued interest receivable and payable approximate fair value and are classified at the same Level as the asset and liability they are associated with.

Derivative financial instruments: Interest rate swaps have principally been valued based on the discounted value of contractual cash flows using a discount rate approximating current market rates and are classified as Level 2 as described in Note #12 and the Amended Warrant has been valued based on a simulation analysis which considers potential outcomes for a large number of independent scenarios and is classified as Level 3 as described in Note #12.

Deposits: Deposits without a stated maturity, including demand deposits, savings, NOW and money market accounts, have a fair value equal to the amount payable on demand. Each of these instruments is classified as Level 1. Deposits with a stated maturity, such as certificates of deposit have been valued based on the discounted value of contractual cash flows using a discount rate approximating current market rates for liabilities with a similar maturity resulting in a Level 2 classification. Deposits include those held for sale relating to branch sale.

Other borrowings: Other borrowings have been valued based on the discounted value of contractual cash flows using a discount rate approximating current market rates for liabilities with a similar maturity resulting in a Level 2 classification.

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Subordinated debentures: Subordinated debentures have generally been valued based on a quoted market price of the specific or similar instruments resulting in a Level 1 or Level 2 classification.

The estimated recorded book balances and fair values follows:

	September 30, 2012				
			Fair Value Measurements Using		
	Recorded Book Balance	Fair Value Measure-ments	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Un-observable Inputs (Level 3)
			(In thousands)		
Assets					
Cash and due from banks	$56,911	$56,911	$56,911	$-	$-
Interest bearing deposits	403,633	403,633	403,633	-	-
Trading securities	38	38	38	-	-
Securities available for sale	230,186	230,186	-	230,186	-
Federal Home Loan Bank and Federal Reserve Bank Stock	20,494	NA	NA	NA	NA
Net loans and loans held for sale	1,478,217	1,437,327	-	94,249	1,343,078
Accrued interest receivable	6,557	6,557	151	954	5,452
Derivative financial instruments	2,787	2,787	-	2,787	-
Liabilities					
Deposits with no stated maturity	$1,630,166	$1,630,166	$1,630,166	$-	$-
Deposits with stated maturity	543,124	545,395	-	545,395	-
Other borrowings	17,720	21,805	-	21,805	-
Subordinated debentures	50,175	39,078	7,362	31,716	-
Accrued interest payable	6,761	6,761	2,735	4,026	-
Derivative financial instruments	2,695	2,695	-	2,310	385

	December 31, 2011	
	Recorded Book Balance	Estimated Fair Value
	(In thousands)	
Assets		
Cash and due from banks	$ 62,777	$ 62,777
Interest bearing deposits	278,331	278,331
Trading securities	77	77
Securities available for sale	157,444	157,444
Federal Home Loan Bank and Federal Reserve Bank Stock	20,828	NA

Net loans and loans held for sale		1,562,525		1,475,738
Accrued interest receivable		6,243		6,243
Derivative financial instruments		857		857
Liabilities				
Deposits with no stated maturity	$	1,517,321	$	1,517,321
Deposits with stated maturity		568,804		571,552
Other borrowings		33,387		37,907
Subordinated debentures		50,175		16,138
Accrued interest payable		5,106		5,106
Derivative financial instruments		1,883		1,883

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The fair values for commitments to extend credit and standby letters of credit are estimated to approximate their aggregate book balance, which is nominal and therefore are not disclosed.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale the entire holdings of a particular financial instrument.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business, the value of future earnings attributable to off-balance sheet activities and the value of assets and liabilities that are not considered financial instruments.

Fair value estimates for deposit accounts do not include the value of the core deposit intangible asset resulting from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

14. Contingent Liabilities

Our Mepco segment conducts its payment plan business activities across the United States. Mepco acquires the payment plans from companies (which we refer to as Mepco's "counterparties") at a discount from the face amount of the payment plan. Each payment plan (which are classified as payment plan receivables in our Condensed Consolidated Statements of Financial Condition) permits a consumer to purchase a vehicle service contract by making installment payments, generally for a term of 12 to 24 months, to the sellers of those contracts (one of the "counterparties"). Mepco thereafter collects the payments from consumers. In acquiring the payment plan, Mepco generally funds a portion of the cost to the seller of the service contract and a portion of the cost to the administrator of the service contract. The administrator, in turn, pays the necessary contractual liability insurance policy ("CLIP") premium to the insurer or risk retention group.

Consumers are allowed to voluntarily cancel the service contract at any time and are generally entitled to receive a refund from the administrator of the unearned portion of the service contract at the time of cancellation. As a result, while Mepco does not owe any refund to the consumer, it also does not have any recourse against the consumer for nonpayment of a payment plan and therefore does not evaluate the creditworthiness of the individual consumer. If a consumer stops making payments on a payment plan or exercises the right to voluntarily cancel the service contract, the service contract seller and administrator are each obligated to refund to Mepco the amount necessary to make Mepco whole as a result of its funding of the service contract. In addition, the insurer or risk retention group that issued the CLIP for the service contract often guarantees all or a portion of the refund to Mepco. See Note #4 above for a breakdown of Mepco's payment plan receivables by the level of recourse Mepco has against various counterparties.

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Upon the cancellation of a service contract and the completion of the billing process to the counterparties for amounts due to Mepco, there is a decrease in the amount of "payment plan receivables" and an increase in the amount of "vehicle service contract counterparty receivables" until such time as the amount due from the counterparty is collected. These amounts represent funds actually due to Mepco from its counterparties for cancelled service contracts. At September 30, 2012, the aggregate amount of such obligations owing to Mepco by counterparties, net of write-downs and reserves made through the recognition of vehicle service contract counterparty contingencies expense, totaled $18.8 million. This compares to a balance of $29.3 million at December 31, 2011. Mepco is currently in the process of working to recover these receivables, including through liquidation of collateral and litigation against counterparties.

In some cases, Mepco requires collateral or guaranties by the principals of the counterparties to secure these refund obligations; however, this is generally only the case when no rated insurance company is involved to guarantee the repayment obligation of the seller and administrator counterparties. In most cases, there is no collateral to secure the counterparties' refund obligations to Mepco, but Mepco has the contractual right to offset unpaid refund obligations against amounts Mepco would otherwise be obligated to fund to the counterparties. In addition, even when collateral is involved, the refund obligations of these counterparties are not fully secured. Mepco incurs losses when it is unable to fully recover funds owing to it by counterparties upon cancellation of the underlying service contracts. The sudden failure of one of Mepco's major counterparties (an insurance company, administrator, or seller/dealer) could expose us to significant losses.

When counterparties do not honor their contractual obligations to Mepco to repay advanced funds, we recognize estimated losses. Mepco pursues collection (including commencing legal action if necessary) of funds due to it under its various contracts with counterparties. Charges related to estimated losses for vehicle service contract counterparty contingencies included in non-interest expenses were $0.3 million and $1.3 million for the three months ended September 30, 2012 and 2011, respectively and $1.1 million and $5.0 million for the nine months ended September 30, 2012 and 2011, respectively. These charges are being classified in non-interest expense because they are associated with a default or potential default of a contractual obligation under our counterparty contracts as opposed to loss on the administration of the payment plan itself.

The determination of losses related to vehicle service contract counterparty contingencies requires a significant amount of judgment because a number of factors can influence the amount of loss that we may ultimately incur. These factors include our estimate of future cancellations of vehicle service contracts, our evaluation of collateral that may be available to recover funds due from our counterparties, and the amount collected from counterparties in connection with their contractual obligations. Mepco is currently involved in litigation with certain of its counterparties in an attempt to collect amounts owing from those counterparties for cancelled service contracts.

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We apply a rigorous process, based upon observable contract activity and past experience, to estimate probable incurred losses and quantify the necessary reserves for our vehicle service contract counterparty contingencies, but there can be no assurance that our modeling process will successfully identify all such losses. As a result, we could record future losses associated with vehicle service contract counterparty contingencies that may be significantly different than the levels that we recorded during the first nine months of 2012 and 2011.

We believe our assumptions regarding the collection of vehicle service contract counterparty receivables are reasonable, and we based them on our good faith judgments using data currently available. We also believe the current amount of reserves we have established and the vehicle service contract counterparty contingencies expense that we have recorded are appropriate given our estimate of probable incurred losses at the applicable Condensed Consolidated Statement of Financial Condition date. However, because of the uncertainty surrounding the numerous and complex assumptions made, actual losses could exceed the charges we have taken to date.

We are also involved in various litigation matters in the ordinary course of business. At the present time, we do not believe any of these matters will have a significant impact on our Condensed Consolidated Financial Statements. The aggregate amount we have accrued for losses we consider probable as a result of these litigation matters is immaterial. However, because of the inherent uncertainty of outcomes from any litigation matter, we believe it is reasonably possible we may incur losses in addition to the amounts we have accrued. At this time, we estimate the maximum amount of additional losses that are reasonably possible is approximately $0.4 million. However, because of a number of factors, including the fact that certain of these litigation matters are still in their early stages and involve claims for which, at this point, we believe have little to no merit, this maximum amount may change in the future.

The litigation matters described in the preceding paragraph primarily include claims that have been brought against us for damages, but do not include litigation matters where we seek to collect amounts owed to us by third parties (such as litigation initiated to collect delinquent loans or vehicle service contract counterparty receivables). These excluded, collection-related matters may involve claims or counterclaims by the opposing party or parties, but we have excluded such matters from the disclosure contained in the preceding paragraph in all cases where we believe the possibility of us paying damages to any opposing party is remote. Risks associated with the likelihood that we will not collect the full amount owed to us, net of reserves, are disclosed elsewhere in this report.

15. Shareholders' Equity

On April 2, 2010, we entered into an exchange agreement with the UST pursuant to which the UST agreed to exchange all 72,000 shares of our Series A Fixed Rate Cumulative Perpetual Preferred Stock, with an original liquidation preference of $1,000 per share ("Series A Preferred Stock"), beneficially owned and held by the UST, plus accrued and unpaid dividends on such Series A Preferred Stock, for shares of our Series B Fixed Rate Cumulative Mandatorily Convertible Preferred Stock, with an original liquidation preference of $1,000 per share ("Series B Preferred Stock"). As part of the terms of the exchange agreement, we also agreed to amend and restate the terms of the warrant, dated December 12, 2008, issued to the UST to purchase 346,154 shares of our common stock.

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On April 16, 2010, we closed the transactions described in the exchange agreement and we issued to the UST (1) 74,426 shares of our Series B Preferred Stock and (2) an Amended and Restated Warrant to purchase 346,154 shares of our common stock at an exercise price of $7.234 per share and expiring on December 12, 2018 (the "Amended Warrant") for all of the 72,000 shares of Series A Preferred Stock and the original warrant that had been issued to the UST in December 2008 pursuant to the TARP Capital Purchase Program, plus approximately $2.4 million in accrued dividends on such Series A Preferred Stock.

With the exception of being convertible into shares of our common stock, the terms of the Series B Preferred Stock are substantially similar to the terms of the Series A Preferred Stock that was exchanged. The Series B Preferred Stock qualifies as Tier 1 regulatory capital and pays cumulative dividends quarterly at a rate of 5% per annum through February 14, 2014, and at a rate of 9% per annum thereafter. The Series B Preferred Stock is non-voting, other than class voting rights on certain matters that could adversely affect the Series B Preferred Stock. If dividends on the Series B Preferred Stock have not been paid for an aggregate of six quarterly dividend periods or more, whether consecutive or not, the holders of the Series B Preferred Stock, voting together with holders of any then outstanding voting parity stock, have the right to elect two additional directors at our next annual meeting of shareholders or at a special meeting of shareholders called for that purpose. These directors would be elected annually and serve until all accrued and unpaid dividends on the Series B Preferred Stock have been paid. Beginning in December of 2009, we suspended payment of quarterly dividends. The cash dividends payable to the UST amount to approximately $4.2 million per year until December of 2013, at which time they would increase to approximately $7.6 million per year. Because we have deferred dividends on the Series B Preferred Stock for at least six quarterly dividend periods, the UST currently has the right to elect two directors to our board. At this time, in lieu of electing such directors, the UST requested us to allow (and we have allowed) an observer to attend our Board of Directors meetings beginning in the third quarter of 2011. The UST continues to retain the right to elect two directors as described above.

Under the terms of the Series B Preferred Stock, UST (and any subsequent holder of the Series B Preferred Stock) has the right to convert the Series B Preferred Stock into our common stock at any time. In addition, we have the right to compel a conversion of the Series B Preferred Stock into common stock, subject to the following conditions:

(i) we shall have received all appropriate approvals from the Board of Governors of the Federal Reserve System;
(ii) we shall have issued our common stock in exchange for at least $40 million aggregate original liquidation amount of the trust preferred securities issued by the Company's trust subsidiaries, IBC Capital Finance II, IBC Capital Finance III, IBC Capital Finance IV, and Midwest Guaranty Trust I;
(iii) we shall have closed one or more transactions (on terms reasonably acceptable to the UST, other than the price per share of common stock) in which investors, other than the UST, have collectively provided a minimum aggregate amount of $100 million in cash proceeds to us in exchange for our common stock; and
(iv) we shall have made the anti-dilution adjustments to the Series B Preferred Stock, if any, required by the terms of the Series B Preferred Stock.

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If converted by the holder or by us pursuant to either of the above-described conversion rights, each share of Series B Preferred Stock (liquidation amount of $1,000 per share) will convert into a number of shares of our common stock equal to a fraction, the numerator of which is $750 and the denominator of which is $7.234, which was the market price of our common stock at the time the exchange agreement was signed (as such market price was determined pursuant to the terms of the Series B Preferred Stock), referred to as the “conversion rate.” This conversion rate is subject to certain anti-dilution adjustments that may result in a greater number of shares being issued to the holder of the Series B Preferred Stock. If converted by the holder or by us pursuant to either of the above-described conversion rights, as of September 30, 2012, the Series B Preferred Stock and accrued and unpaid dividends would have been convertible into approximately 11.2 million shares of our common stock.

Unless earlier converted by the holder or by us as described above, the Series B Preferred Stock will convert into shares of our common stock on a mandatory basis on the seventh anniversary (April 16, 2017) of the issuance of the Series B Preferred Stock. In any such mandatory conversion, each share of Series B Preferred Stock (liquidation amount of $1,000 per share) will convert into a number of shares of our common stock equal to a fraction, the numerator of which is $1,000 and the denominator of which is the market price of our common stock at the time of such mandatory conversion (as such market price is determined pursuant to the terms of the Series B Preferred Stock).

At the time any Series B Preferred Stock are converted into our common stock, we will be required to pay all accrued and unpaid dividends on the Series B Preferred Stock being converted in cash or, at our option, in shares of our common stock, in which case the number of shares to be issued will be equal to the amount of accrued and unpaid dividends to be paid in common stock divided by the market value of our common stock at the time of conversion (as such market price is determined pursuant to the terms of the Series B Preferred Stock). Accrued and unpaid dividends on the Series B Preferred Stock totaled $9.7 million (approximately $130 per share of Series B Preferred Stock) and $6.6 million (approximately $89 per share of Series B Preferred Stock) at September 30, 2012 and December 31, 2011, respectively. These amounts are recorded in Convertible Preferred Stock on the Condensed Consolidated Statements of Financial Condition.

The maximum number of shares of our common stock that may be issued upon conversion of all shares of the Series B Preferred Stock and any accrued dividends on Series B Preferred Stock is 14.4 million, unless we receive shareholder approval to issue a greater number of shares.

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(unaudited)

The Series B Preferred Stock may be redeemed by us, subject to the approval of the Board of Governors of the Federal Reserve System, at any time, in an amount up to the cash proceeds (minimum of approximately $18.6 million) from qualifying equity offerings of common stock (plus any net increase to our retained earnings after the original issue date). If the Series B Preferred Stock is redeemed the redemption price will be the greater of (a) the $1,000 liquidation amount per share plus any accrued and unpaid dividends and (b) the product of the applicable Conversion Rate (as described above) and the average of the market prices per share of our common stock (as such market price is determined pursuant to the terms of the Series B Preferred Stock) over a 20 trading day period beginning on the trading day immediately after we give notice of redemption to the holder (plus any accrued and unpaid dividends). In any redemption, we must redeem at least 25% of the number of Series B Preferred Stock shares originally issued to the UST, unless fewer of such shares are then outstanding (in which case all of the Series B Preferred Stock must be redeemed). In addition to the terms of the Series B Preferred Stock discussed above, the UST updated its Frequently Asked Questions regarding the Capital Purchase Program ("CPP") as of March 1, 2012 to permit any CPP participant to repay its investment, in part, subject to a minimum repayment of the greater of (i) 5% of the aggregate liquidation amount of the preferred stock issued to the UST or (ii) $100,000. Under this updated guidance, we could repay a minimum of approximately $3.7 million, subject to the approval of the Board of Governors of the Federal Reserve System, in a partial redemption of the Series B Preferred Stock.

On July 7, 2010 we executed an Investment Agreement and Registration Rights Agreement with Dutchess Opportunity Fund, II, LP ("Dutchess") for the sale of up to 1.50 million shares of our common stock. These agreements serve to establish an equity line facility as a contingent source of liquidity at the parent company level. Pursuant to the Investment Agreement, Dutchess committed to purchase up to $15.0 million of our common stock over a 36-month period ending November 1, 2013. We have the right, but no obligation, to draw on this equity line facility from time to time during such 36-month period by selling shares of our common stock to Dutchess. The sales price would be at a 5% discount to the market price of our common stock at the time of the draw; as such market price is determined pursuant to the terms of the Investment Agreement. Through September 30, 2012, 0.97 million shares of our common stock were sold to Dutchess pursuant to the Investment Agreement (0.02 million shares during the third quarter of 2012, 0.17 million shares during the second quarter of 2012, 0.43 million shares during 2011 and 0.35 million shares during the fourth quarter of 2010) for an aggregate purchase price of $2.4 million. In order to comply with Nasdaq rules, we needed shareholder approval to sell more than approximately 0.7 million more shares to Dutchess pursuant to the Investment Agreement. In April 2011, our shareholders approved a resolution at our Annual Meeting to authorize us to sell up to 2.5 million additional shares under this equity line, so we now have additional flexibility to take advantage of this contingent source of liquidity. Remaining shares approved to sell pursuant to the Investment Agreement totaled 3.0 million shares at September 30, 2012. Based on our closing stock price on September 30, 2012, additional funds available under the Investment Agreement totaled approximately $8.2 million at September 30, 2012.

16. Branch Sale

On May 23, 2012 we executed a definitive agreement to sell 21 branches to Chemical Bank, headquartered in Midland, Michigan (the "Branch Sale"). The branches to be sold include 6 branch locations in the Battle Creek, Michigan market area and 15 branch locations in Northeast Michigan.

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

We expect that the Branch Sale will result in the transfer of approximately $408.6 million of deposits to Chemical Bank in exchange for the payment of a deposit premium of approximately $11.8 million. This represents a deposit premium of approximately 3.0% on identified core deposits. Certain non-core deposits will be transferred at no premium. Chemical Bank will also have the right to purchase certain loans associated with the branches being sold, at a discount of 1.75%. Currently, we estimate that approximately $53.2 million of loans will be sold to Chemical Bank. These loans are classified as held for sale in the September 30, 2012 Condensed Consolidated Statement of Financial Condition and are carried at the lower of cost or fair value. Certain fixed assets with a fair value at September 30, 2012 of approximately $8.4 million (cost, net of accumulated depreciation of approximately $10.9 million) are expected to be sold and are also classified as held for sale in the September 30, 2012 Condensed Consolidated Statement of Financial Condition. In addition, approximately $2.6 million of remaining unamortized intangible assets at September 30, 2012 relate to customers and deposits associated with the pending Branch Sale. The Branch Sale is expected to be completed by the end of the fourth quarter of 2012, subject to the satisfaction of terms and conditions of sale. Based on the deposit premium outlined above, we expect to record a net gain on the Branch Sale of approximately $5.8 million. This estimated gain is net of an allocation of $2.6 million of existing core deposit intangibles, a $2.5 million loss on the sale of fixed assets, a $0.3 million loss on the sale of loans and $0.6 million in transaction related costs.

The following summarizes estimated loans and deposits related to the Branch Sale:

	September 30, 2012 (In thousands)
Loans:	
Commercial	$31,060
Mortgage	8,569
Installment	13,582
Total loans	53,211
Allowance for loan losses	(610)
Adjustment to lower of cost or fair value	(321)
Net loans	$52,280
Deposits	
Non-interest bearing	$66,392
Savings and interest bearing-checking	225,062
Retail time	117,180
Total deposits	408,634
Net adjustments	(2,784)
Net deposits	$405,850

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ITEM 2.

Management's Discussion and Analysis
of Financial Condition and Results of Operations

The following section presents additional information that may be necessary to assess our financial condition and results of operations. This section should be read in conjunction with our condensed consolidated financial statements contained elsewhere in this report as well as our 2011 Annual Report on Form 10-K. The Form 10-K includes a list of risk factors that you should consider in connection with any decision to buy or sell our securities.

Introduction. Our success depends to a great extent upon the economic conditions in Michigan's Lower Peninsula. We have in general experienced a difficult economy in Michigan since 2001, although economic conditions in the state began to show signs of improvement during 2010 and generally these improvements have continued into 2012, albeit at a slower pace.

We provide banking services to customers located primarily in Michigan's Lower Peninsula. Our loan portfolio, the ability of the borrowers to repay these loans and the value of the collateral securing these loans has been and will be impacted by local economic conditions. The weaker economic conditions faced in Michigan have had and may continue to have adverse consequences as described below in "Portfolio Loans and asset quality." However, since early- to mid-2009, we have generally seen a decline in non-performing loans and a declining level of provision for loan losses.

In response to these difficult market conditions and the significant losses that we incurred from 2008 through 2011 that reduced our capital, we have taken steps or initiated actions designed to increase our capital ratios, improve our operations and augment our liquidity as described in more detail below.

On May 23, 2012 we executed a definitive agreement to sell 21 branches to Chemical Bank, headquartered in Midland, Michigan (the "Branch Sale"). The branches to be sold include 6 branch locations in the Battle Creek, Michigan market area and 15 branch locations in Northeast Michigan.

We expect that the Branch Sale will result in the transfer of approximately $408.6 million of deposits to Chemical Bank in exchange for the payment of a deposit premium of approximately $11.8 million. This represents a deposit premium of approximately 3.0% on identified core deposits. Certain non-core deposits will be transferred at no premium. Chemical Bank also has the right to purchase certain loans originated at the branches being sold, at a discount of 1.75%. Currently, we estimate that approximately $53.2 million of loans will be sold to Chemical Bank. These loans are classified as held for sale in the September 30, 2012 Condensed Consolidated Statement of Financial Condition and are carried at the lower of cost or fair value. The Branch Sale is expected to be completed by the end of 2012. Based on the deposit premium outlined above, we expect to record a net gain on the Branch Sale of approximately $5.8 million. This estimated gain is net of an allocation of $2.6 million of existing core deposit intangibles, a $2.5 million loss on the sale of fixed assets, a $0.3 million loss on the sale of loans and $0.6 million in transaction related costs.

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At the present time, based on our current forecasts and expectations, we believe that our Bank can remain above "well-capitalized" for regulatory purposes for the foreseeable future, even without additional capital, primarily because of our reduction in total assets and our return to profitability during 2012. Our forecast for future profitability reflects an expectation for reduced credit costs (in particular the provision for loan losses, net losses on other real estate ["ORE"] and repossessed assets and loan and collection costs) that is anticipated to be partially offset by a decline in net interest income (due primarily to a change in asset mix as higher yielding loans are expected to continue to decline and lower yielding investment securities are expected to increase as well as due to the impact of the Branch Sale). This forecast is susceptible to significant variations, particularly if the Michigan economy were to deteriorate and credit costs were to be higher than anticipated or if we incur any significant future losses at Mepco Finance Corporation ("Mepco") related to the collection of vehicle service contract counterparty receivables (see "Non-interest expense"). Because of such uncertainties, it is possible that our Bank may not be able to remain well-capitalized as we work through asset quality issues and seek to return to consistent profitability. As described in more detail under "Liquidity and capital resources" below, we believe failing to remain well-capitalized would have a material adverse effect on our business and financial condition as it would, among other consequences, likely lead to further regulatory enforcement actions (see "Regulatory development"), a potential loss of our mortgage servicing rights with Fannie Mae and/or Freddie Mac, and limits on our access to certain wholesale funding sources. In addition, any significant deterioration in our ability to improve our capital position would make it very difficult for us to withstand future losses that we may incur and that may be increased or made more likely as a result of economic difficulties and other factors.

In July 2010, Congress passed and the President signed into law the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Dodd-Frank Act"). The Dodd-Frank Act includes the creation of the new Consumer Financial Protection Bureau with power to promulgate and enforce consumer protection laws; the creation of the Financial Stability Oversight Council chaired by the Secretary of the Treasury with authority to identify institutions and practices that might pose a systemic risk; provisions affecting corporate governance and executive compensation of all companies whose securities are registered with the SEC; a provision that broadened the base for Federal Deposit Insurance Corporation ("FDIC") insurance assessments; a provision under which interchange fees for debit cards are set by the Federal Reserve Bank ("FRB") under a restrictive "reasonable and proportional cost" per transaction standard; a provision that requires bank regulators to set minimum capital levels for bank holding companies that are as strong as those required for their insured depository subsidiaries, subject to a grandfather clause for financial institutions with less than $15 billion in assets as of December 31, 2009; and new restrictions on how mortgage brokers and loan originators may be compensated. Certain provisions of the Dodd-Frank Act only apply to institutions with more than $10 billion in assets. The Dodd-Frank Act has had (and we expect it will continue to have) a significant impact on the banking industry, including our organization.

On June 4, 2012, the Board of Governors of the Federal Reserve System issued Notices of Proposed Rulemaking ("NPR") – Enhancements to the Regulatory Capital Requirements (the "Proposed New Capital Requirements"). These Proposed New Capital Requirements, if adopted as outlined in the NPR, would have a material impact on the banking industry, including our organization. In general the Proposed New Capital Requirements would significantly increase the need for Tier 1 common equity capital and substantially impact the calculation of risk-weighted assets. See "Liquidity and Capital Resources."

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It is against this backdrop that we discuss our results of operations for the third quarter and first nine months of 2012 as compared to 2011 and our financial condition as of September 30, 2012.

Results of Operations

Summary. We recorded net income of $6.4 million and net income applicable to common stock of $5.4 million during the three months ended September 30, 2012 compared to a net loss of $4.1 million and a net loss applicable to common stock of $5.2 million during the comparable period in 2011. The improvement in 2012 results as compared to 2011 primarily reflects decreases in the provision for loan losses and non-interest expenses and an increase in non-interest income that were partially offset by a decrease in net interest income.

We recorded net income of $14.3 million and net income applicable to common stock of $11.0 million during the nine months ended September 30, 2012 compared to a net loss of $11.5 million and a net loss applicable to common stock of $14.6 million during the comparable period in 2011. The reasons for the changes in the year-to-date comparative periods are generally commensurate with the quarterly comparative periods.

Key performance ratios

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net income (loss) (annualized) to(1)				
Average assets	0.89 %	(0.89)%	0.62 %	(0.81)%
Average common shareholders' equity	62.71	(56.07)	52.38	(52.57)
Net income (loss) per common share(1)				
Basic	$0.61	$(0.61)	$1.28	$(1.78)
Diluted	0.16	(0.61)	0.36	(1.78)

(1) These amounts are calculated using net income (loss) applicable to common stock.

Net interest income. Net interest income is the most important source of our earnings and thus is critical in evaluating our results of operations. Changes in our net interest income are primarily influenced by our level of interest-earning assets and the income or yield that we earn on those assets and the manner and cost of funding our interest-earning assets. Certain macro-economic factors can also influence our net interest income such as the level and direction of interest rates, the difference between short-term and long-term interest rates (the steepness of the yield curve) and the general strength of the economies in which we are doing business. Finally, risk management plays an important role in our level of net interest income. The ineffective management of credit risk and interest-rate risk in particular can adversely impact our net interest income.

Our net interest income totaled $21.5 million during the third quarter of 2012, a decrease of $2.3 million, or 9.8% from the year-ago period. Our net interest income as a percent of average interest-earning assets (the "net interest margin") was 3.92% during the third quarter of 2012, compared to 4.59% in the year-ago period. The net interest margin decreased due primarily to a change in asset mix, as higher yielding loans declined and lower yielding short-term investments increased. The quarterly year-over-year decrease in net interest income was partially offset by an increase in average interest-earning assets, which rose to $2.18 billion in the third quarter of 2012 compared to $2.06 billion in the year-ago quarter. The increase in average interest-earning assets primarily reflects a rise in securities available for sale and overnight interest bearing balances at the Federal Reserve Bank that were partially offset by a decline in loans.

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For the first nine months of 2012, net interest income totaled $65.4 million, a decrease of $6.2 million, or 8.7% from 2011. The Company's net interest margin for the first nine months of 2012 decreased to 4.03% compared to 4.43% in 2011. The reasons for the decline in net interest income for the first nine months of 2012 are generally consistent with those described above for the comparative quarterly periods.

Beginning in the last half of 2009 and continuing into the first nine months of 2012, we increased our level of lower-yielding interest bearing cash balances and investment securities to augment our liquidity in response to our stressed financial condition (see "Liquidity and capital resources") and to provide the future funding needed for the pending Branch Sale. In addition, due to the challenges facing Mepco (see "Noninterest expense"), we have been reducing the balance of payment plan receivables beginning in late 2009 and continuing into the first nine months of 2012. These payment plan receivables are the highest yielding segment of our loan portfolio, with an average yield of approximately 13% to 14%. The combination of these items (an increase in the level of lower-yielding interest bearing cash balances and investment securities and a decrease in the level of higher-yielding loans, including payment plan receivables) has had an adverse impact on our 2012 net interest income and net interest margin.

Our net interest income is also adversely impacted by our level of non-accrual loans. In the third quarter and first nine months of 2012 non-accrual loans averaged $41.7 million and $48.5 million, respectively compared to $53.4 million and $57.8 million, respectively for the same periods in 2011. In addition, in the third quarter and first nine months of 2012 we had net recoveries of $0.2 million and $0.2 million, respectively, of accrued and unpaid interest on loans placed on or taken off non-accrual during each period compared to net reversals of $0.1 million and $0.2 million, respectively during the same periods in 2011.

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Average Balances and Rates

	Three Months Ended September 30,					
	2012			2011		
	Average Balance	Interest	Rate(3)	Average Balance	Interest	Rate(3)
Assets (1)	(Dollars in thousands)					
Taxable loans	$ 1,532,773	$ 23,312	6.05 %	$ 1,668,940	$ 27,140	6.47 %
Tax-exempt loans (2)	6,709	73	4.33	7,728	82	4.21
Taxable securities	217,427	655	1.20	49,911	297	2.36
Tax-exempt securities (2)	26,116	261	3.98	29,259	301	4.08
Cash – interest bearing	377,899	243	0.26	282,170	179	0.25
Other investments	20,494	189	3.67	21,005	188	3.55
Interest Earning Assets	2,181,418	24,733	4.52	2,059,013	28,187	5.44
Cash and due from banks	56,289			56,233		
Other assets, net	161,971			192,282		
Total Assets	$2,399,678			$ 2,307,528		
Liabilities						
Savings and NOW	$ 1,079,389	494	0.18	$ 1,008,525	608	0.24
Time deposits	549,319	1,729	1.25	577,723	2,622	1.80
Other borrowings	67,994	1,059	6.20	86,696	1,183	5.41
Interest Bearing Liabilities	1,696,702	3,282	0.77	1,672,944	4,413	1.05
Demand deposits	545,945			477,093		
Other liabilities	40,477			42,614		
Shareholders' equity	116,554			114,877		
Total liabilities and shareholders' equity	$2,399,678			$ 2,307,528		
Net Interest Income		$ 21,451			$ 23,774	
Net Interest Income as a Percent of Earning Assets			3.92 %			4.59 %

(1) All domestic, except for none and $0.01 million for the three months ended September 30, 2012 and 2011, respectively, of average payment plan receivables included in taxable loans for customers domiciled in Canada.

(2) Interest on tax-exempt loans and securities is not presented on a fully tax equivalent basis due to the current net operating loss carryforward position and the deferred tax asset valuation allowance.

(3) Annualized.

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Average Balances and Rates

	Nine Months Ended September 30,					
	2012			2011		
	Average Balance	Interest	Rate(3)	Average Balance	Interest	Rate(3)
Assets (1)	(Dollars in thousands)					
Taxable loans	$ 1,557,164	$ 71,209	6.11%	$ 1,728,076	$ 84,554	6.54%
Tax-exempt loans (2)	7,010	218	4.15	8,064	254	4.21
Taxable securities	221,245	2,246	1.36	51,010	1,108	2.90
Tax-exempt securities (2)	26,563	801	4.03	30,087	931	4.14
Cash – interest bearing	334,426	638	0.25	319,288	605	0.25
Other investments	20,628	572	3.70	22,486	580	3.45
Interest Earning Assets	2,167,036	75,684	4.67	2,159,011	88,032	5.45
Cash and due from banks	54,619			52,475		
Other assets, net	163,058			191,215		
Total Assets	$2,384,713			$2,402,701		
Liabilities						
Savings and NOW	$1,071,169	1,452	0.18	$1,005,436	1,805	0.24
Time deposits	565,731	5,500	1.30	687,043	10,881	2.12
Other borrowings	73,714	3,351	6.07	95,337	3,738	5.24
Interest Bearing Liabilities	1,710,614	10,303	0.80	1,787,816	16,424	1.23
Demand deposits	524,615			456,514		
Other liabilities	39,810			43,977		
Shareholders’ equity	109,674			114,394		
Total liabilities and shareholders’ equity	$2,384,713			$2,402,701		
Net Interest Income		$65,381			$71,608	
Net Interest Income as a Percent of Earning Assets			4.03 %			4.43 %

(1) All domestic, except for none and $0.02 million for the nine months ended September 30, 2012 and 2011, respectively, of average payment plan receivables included in taxable loans for customers domiciled in Canada.
(2) Interest on tax-exempt loans and securities is not presented on a fully tax equivalent basis due to the current net operating loss carryforward position and the deferred tax asset valuation allowance.
(3) Annualized.

Provision for loan losses. The provision for loan losses was $0.3 million and $6.2 million during the three months ended September 30, 2012 and 2011, respectively. During the nine-month periods ended September 30, 2012 and 2011, the provision was $6.4 million and $21.0 million, respectively. The provision reflects our assessment of the allowance for loan losses taking into consideration factors such as loan mix, levels of non-performing and classified loans and loan net charge-offs. While we use relevant information to recognize losses on loans, additional provisions for related losses may be necessary based on changes in economic conditions, customer circumstances and other credit risk factors. The decrease in the provision for loan losses in the third quarter and first nine months of 2012 primarily reflects reduced levels of non-performing loans, lower total loan balances and a decline in loan net charge-offs. See “Portfolio Loans and asset quality” for a discussion of the various components of the allowance for loan losses and their

impact on the provision for loan losses in the third quarter and first nine months of 2012.

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Non-interest income. Non-interest income is a significant element in assessing our results of operations. We regard net gains on mortgage loans as a core recurring source of revenue but they are quite cyclical and thus can be volatile. We regard net gains (losses) on securities as a "non-operating" component of non-interest income.

Non-interest income totaled $14.5 million during the three months ended September 30, 2012, a $5.3 million increase from the comparable period in 2011. For the first nine months of 2012 non-interest income totaled $42.2 million, a $7.7 million increase from the comparable period in 2011. The increase in non-interest income is primarily due to a significant rise in net gains on mortgage loans and a reduced loss from mortgage loan servicing.

Non-Interest Income

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Service charges on deposit accounts	$4,739	$4,623	$13,492	$13,689
Interchange income	2,324	2,356	7,053	6,832
Net gains (losses) on assets:				
Mortgage loans	4,602	2,025	12,041	5,753
Securities	301	(57)	1,154	271
Other than temporary loss on securities available for sale:				
Total impairment loss	(70)	(4)	(332)	(146)
Recognized in other comprehensive loss	-	-	-	-
Net impairment loss in earnings	(70)	(4)	(332)	(146)
Mortgage loan servicing	(364)	(2,655)	(716)	(1,885)
Investment and insurance commissions	491	534	1,586	1,613
Bank owned life insurance	398	496	1,221	1,385
Title insurance fees	482	299	1,479	1,090
Change in U.S. Treasury Warrant fair value	(32)	29	(211)	1,025
Other	1,671	1,609	5,401	4,795
Total non-interest income	$14,542	$9,255	$42,168	$34,422

Service charges on deposit accounts increased slightly during the three-month period and declined slightly during the nine-month period ended September 30, 2012, respectively, from the comparable periods in 2011. The quarterly growth in such service charges primarily reflects increases in certain account level fees (primarily on treasury management products) that were implemented in the third quarter of 2012. The decrease in such service charges on a year-to-date comparative basis primarily relates to a decline in non-sufficient funds ("NSF") occurrences and related NSF fees. We believe the decline in NSF occurrences is principally due to our customers managing their finances more closely in order to reduce NSF activity and avoid the associated fees.

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Interchange income was relatively unchanged on a comparative quarterly basis and increased by 3.2% on a year-to-date basis in 2012 compared to 2011. The year-to-date growth in interchange income primarily reflects an increase in debit card transaction volumes, although such transaction volumes did level off in the third quarter of 2012. As described earlier, the Dodd-Frank Act includes a provision under which interchange fees for debit cards are set by the Federal Reserve under a restrictive "reasonable and proportional cost" per transaction standard. On June 29, 2011 the Federal Reserve issued final rules (that were effective October 1, 2011) on interchange fees for debit cards. Overall, these final rules established price caps for debit card interchange fees that were approximately 50% lower than previous averages. However, debit card issuers with less than $10 billion in assets (like us) are exempt from this rule. On a long-term basis, it is not clear how competitive market factors may impact debit card issuers who are exempt from the rule. As a result, at the present time, we cannot predict if our interchange income will be lower in the future because of such price caps.

Net gains on mortgage loans increased significantly on both a quarterly and a year-to-date basis. Mortgage loan activity is summarized as follows:

Mortgage Loan Activity

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Mortgage loans originated	$135,263	$89,526	$384,896	$259,711
Mortgage loans sold	128,196	80,993	367,350	265,850
Mortgage loans sold with servicing rights released	21,942	25,179	59,837	60,179
Net gains on mortgage loans	4,602	2,025	12,041	5,753
Net gains as a percent of mortgage loans sold ("Loan Sales Margin")	3.59 %	2.50 %	3.28 %	2.16 %
Fair value adjustments included in the Loan Sales Margin	0.29	0.15	0.45	(0.14)

The volume of loans sold is dependent upon our ability to originate mortgage loans as well as the demand for fixed-rate obligations and other loans that we choose to not put into portfolio because of our established interest-rate risk parameters. (See "Portfolio Loans and asset quality.") Net gains on mortgage loans are also dependent upon economic and competitive factors as well as our ability to effectively manage exposure to changes in interest rates and thus can often be a volatile part of our overall revenues.

Net gains as a percentage of mortgage loans sold (our "Loan Sales Margin") are impacted by several factors including competition and the manner in which the loan is sold (with servicing rights retained or released). Our decision to sell or retain mortgage loan servicing rights is primarily influenced by an evaluation of the price being paid for mortgage loan servicing by outside third parties compared to our calculation of the economic value of retaining such servicing. The sale of mortgage loan servicing rights may result in declines in mortgage loan servicing income in future periods. Net gains on mortgage loans are also impacted by recording fair value accounting adjustments. Excluding the aforementioned accounting adjustments, the Loan Sales Margin would have been 3.30% and 2.35% in the third quarters of 2012 and 2011, respectively and 2.83% and 2.30% for the comparative 2012 and 2011 year-to-date periods, respectively. The increase in the Loan Sales Margin (excluding fair value adjustments) in 2012 was generally due to more favorable competitive conditions including wider primary-to-secondary market pricing spreads. The changes in the fair value accounting adjustments are primarily due to changes in the amount of commitments to originate mortgage loans for sale.

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Net gains on securities were $0.3 million and $1.2 million during the three and nine months ended September 30, 2012, respectively, and $0.3 million for the nine months ended September 30, 2011. We recorded a net loss on securities of $0.1 million in the third quarter of 2011. The 2012 net gains on securities were due primarily to the sale of U.S. agency residential mortgage-backed investment securities. The third quarter 2011 net loss on securities was due primarily to a decline in the fair value of trading securities. The year to date 2011 net gain on securities was due primarily to the sale of U.S. agency residential mortgage-backed investment securities and a U.S. Treasury security.

We recorded net other than temporary impairment charges on securities available for sale of $0.1 million and $0.3 million during the three and nine months ended September 30, 2012, respectively, and $0.004 million and $0.1 million for the respective comparable periods in 2011. These impairment charges related to private label residential mortgage-backed investment securities. (See “Securities.”)

Mortgage loan servicing generated a loss of $0.4 million and $0.7 million in the third quarter and first nine months of 2012, respectively, compared to a loss of $2.7 million and $1.9 million in the corresponding periods of 2011, respectively. These variances are primarily due to changes in the valuation allowance on and the amortization of capitalized mortgage loan servicing rights. The period end valuation allowance is based on the valuation of the mortgage loan servicing portfolio. The impairment charges incurred in the third quarters of both 2012 and 2011 primarily reflect lower mortgage loan interest rates during those quarters resulting in higher estimated future prepayment rates being used in the quarter end valuation. Activity related to capitalized mortgage loan servicing rights is as follows:

Capitalized Mortgage Loan Servicing Rights

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Balance at beginning of period	$10,651	$ 14,741	$11,229	$ 14,661
Originated servicing rights capitalized	996	573	2,948	2,068
Amortization	(1,052)	(688)	(3,351)	(2,011)
(Increase)/decrease in impairment reserve	(390)	(3,077)	(621)	(3,169)
Balance at end of period	$10,205	$ 11,549	$10,205	$ 11,549
Impairment reserve at end of period	$7,165	$ 6,379	$7,165	$ 6,379

At September 30, 2012 we were servicing approximately $1.76 billion in mortgage loans for others on which servicing rights have been capitalized. This servicing portfolio had a weighted average coupon rate of 4.93% and a weighted average service fee of approximately 25.4 basis points. Remaining capitalized mortgage loan servicing rights at September 30, 2012 totaled $10.2 million, representing approximately 58 basis points on the related amount of mortgage loans serviced for others. The capitalized mortgage loan servicing had an estimated fair market value of $10.4 million at September 30, 2012.

Nearly all of our mortgage loans serviced for others at September 30, 2012 are for either Fannie Mae or Freddie Mac. If our Bank were to fall below “well capitalized” (as defined by banking regulations) it is possible that Fannie Mae and Freddie Mac could require us to very quickly sell or transfer such servicing rights to a third party or unilaterally strip us of such servicing rights if we cannot complete an approved transfer. Depending on the terms of any such transaction, this forced sale or transfer of such mortgage loan servicing rights could have a material adverse impact on our financial condition and results of operations.

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Investment and insurance commissions were down slightly on a comparative quarterly and year-to-date basis in 2012 compared to 2011. Although we have made efforts to expand this business, this decline in 2012 is due primarily to the loss of an experienced investment representative in one of our markets.

Income from bank owned life insurance decreased on both a comparative quarterly and year-to-date basis in 2012 compared to 2011 primarily reflecting a lower average crediting rate on our cash surrender value due to reduced total returns on the underlying separate account assets. Our separate account is primarily invested in U.S. agency residential mortgage-backed securities and managed by PIMCO. The crediting rate (on which the earnings are based) reflects the performance of the separate account. The total cash surrender value of our bank owned life insurance was $50.5 million and $49.3 million at September 30, 2012 and December 31, 2011, respectively.

Title insurance fees were higher on both a comparative quarterly and year-to-date basis in 2012 compared to 2011 primarily as a result of an increase in mortgage lending origination volume.

Changes in the fair value of the amended warrant issued to the U.S. Department of the Treasury (“UST”) in April 2010 are recorded as a component of non-interest income. The fair value of this amended warrant is included in accrued expenses and other liabilities in our Condensed Consolidated Statements of Financial Condition. (See “Liquidity and capital resources.”) Two significant inputs in our valuation model for the amended warrant are our common stock price and the probability percentage of triggering anti-dilution provisions in this instrument related to certain equity transactions. The third quarter and first nine months of 2012, included $0.03 million and $0.2 million of expense, respectively, related to an increase in the fair value of the warrant due primarily to a rise in our common stock price. The third quarter and first nine months of 2011, included $0.03 million and $1.0 million of income, respectively, related to a decline in the fair value of the warrant due primarily to the use of a lower probability of triggering the anti-dilution provisions. (See “Liquidity and capital resources.”)

Other non-interest income increased slightly on a comparative quarterly basis and by $0.6 million on a year-to-date basis in 2012 compared to 2011. The year-to-date increase in 2012 is due to improvement ($0.15 million of earnings in 2012 compared to a $0.04 million loss in 2011) in the performance of our private mortgage reinsurance captive, a $0.25 million increase in rental income (which is generated primarily on ORE properties) and a $0.17 million increase in ATM fees. The improved 2012 performance of our private mortgage reinsurance captive reflects a decline in mortgage loan defaults and lower private mortgage insurance claims.

Non-interest expense. Non-interest expense is an important component of our results of operations. We strive to efficiently manage our cost structure and management is focused on a number of initiatives to reduce and contain non-interest expenses.

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Non-interest expense decreased by $2.2 million to $29.3 million and by $10.4 million to $86.8 million during the three- and nine-month periods ended September 30, 2012, respectively, compared to the like periods in 2011. These decreases are primarily due to declines in loan and collection costs (year-to-date only), occupancy and furniture, fixtures and equipment expenses, net losses on ORE and repossessed assets, credit card and bank service fees, vehicle service contract counterparty contingencies, and other non-interest expenses.

Non-Interest Expense

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
	(in thousands)			
Compensation	$9,702	$10,158	$29,198	$29,990
Performance-based compensation	1,712	281	3,532	772
Payroll taxes and employee benefits	2,196	2,215	6,868	7,270
Compensation and employee benefits	13,610	12,654	39,598	38,032
Loan and collection	2,832	2,658	8,129	10,105
Occupancy, net	2,482	2,651	7,688	8,415
Data processing	2,492	2,502	7,281	7,227
Furniture, fixtures and equipment	1,194	1,308	3,795	4,228
Legal and professional	952	751	3,117	2,330
Communications	785	863	2,486	2,700
FDIC deposit insurance	816	885	2,489	2,772
Net losses on ORE and repossessed assets	291	1,931	1,911	4,114
Credit card and bank service fees	433	869	1,708	2,929
Advertising	647	740	1,842	1,964
Vehicle service contract counterparty contingencies	281	1,345	1,078	5,002
Supplies	299	376	1,033	1,170
Provision for loss reimbursement on sold loans	193	251	751	1,020
Write-down of property and equipment held for sale	860	-	860	-
Amortization of intangible assets	272	343	816	1,029
Costs (recoveries) related to unfunded lending commitments	(538)	(172)	(597)	12
Other	1,395	1,507	2,843	4,186
Total non-interest expense	$29,296	$31,462	$86,828	$97,235

Compensation and employee benefits expenses increased by $1.0 million to $13.6 million and by $1.6 million to $39.6 million during the three- and nine-month periods ended September 30, 2012, respectively, compared to 2011. Compensation expense declined due primarily to a reduction in our average number of full time equivalent employees in 2012 compared to year ago levels. Also payroll taxes and employee benefits declined due primarily to a decrease in medical insurance costs due to both a reduction in the number of insured employees as well as somewhat reduced claims. However, more than offsetting the aforementioned decreases was an increase in performance based compensation due primarily to accruals recorded in the third quarter and first nine months of 2012 of $0.9 million and $1.8 million, respectively, for anticipated incentive based compensation and $0.4 million and $0.8 million, respectively, for an anticipated employee stock ownership plan contribution. These accruals were recorded because of our improved overall performance in 2012, which is now expected to lead to the payout of incentive based compensation.

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Loan and collection expenses increased by $0.2 million to $2.8 million and decreased by $2.0 million to $8.1 million during the three- and nine-month periods ended September 30, 2012, respectively, compared to 2011. Loan and collection expenses primarily reflect costs related to the management and collection of non-performing loans and other problem credits. These expenses (although still at an elevated level compared to historic norms) have declined on a year-to-date basis in 2012, which primarily reflects the overall decrease in the volume of problem credits (non-performing loans and “watch” credits). (See “Portfolio Loans and asset quality.”)

Occupancy, net decreased on both a comparative quarterly and year-to-date basis due primarily to lower snow removal and utilities costs in 2012 which reflect an unseasonably warm winter in Michigan in 2012 as well as a reduction in the number of branch offices due to the consolidation or closing of certain locations in late 2011 and early 2012.

The current year levels of data processing, furniture, fixtures and equipment, communications, advertising and supplies were generally comparable to or lower than the prior year. Collectively, these expense categories declined by $0.4 million, or 6.4%, and by $0.9 million, or 4.9%, during the third quarter and first nine months of 2012, respectively, compared to the year ago periods due primarily to our cost reduction efforts.

Legal and professional fees increased on both a comparative quarterly and year-to-date basis. This increase is primarily due to expenses associated with certain consulting services, various regulatory matters, the Branch Sale, and legal costs at Mepco associated with litigation being pursued against certain business counterparties.

FDIC deposit insurance expense decreased on both a comparative quarterly and year-to-date basis principally reflecting a new rate structure implemented by the FDIC, which became effective at the beginning of the second quarter of 2011. The new rate structure has a lower assessment rate but is based on total assets as compared to the prior structure that was based primarily on total deposits but had a higher assessment rate. In addition, the third quarter of 2011 included $0.1 million of additional expense related to the final actual second quarter 2011 assessment compared to what had been accrued for at June 30, 2011.

Net losses on ORE and repossessed assets primarily represent the loss on the sale or additional write downs on these assets subsequent to the transfer of the asset from our loan portfolio. This transfer occurs at the time we acquire the collateral that secured the loan. At the time of acquisition, the other real estate or repossessed asset is valued at fair value, less estimated costs to sell, which becomes the new basis for the asset. Any write-downs at the time of acquisition are charged to the allowance for loan losses. The reduced net losses in 2012, as compared to 2011, primarily reflects some stability in real estate prices during the last twelve months, with some markets even experiencing modest price increases. However, foreclosed properties generally continue to have distressed valuations.

Credit card and bank service fees decreased on both a comparative quarterly and year-to-date basis primarily due to a decline in the number of payment plans being serviced by Mepco in 2012 compared to 2011. In addition, in the third quarter of 2012, Mepco entered into a new contract with a different vendor for credit card processing services that has a significantly lower fee structure.

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We record estimated incurred losses associated with Mepco's vehicle service contract payment plan receivables in our provision for loan losses and establish a related allowance for loan losses. (See "Portfolio Loans and asset quality.") We record estimated incurred losses associated with defaults by Mepco's counterparties as "vehicle service contract counterparty contingencies expense," which is included in non-interest expenses in our Condensed Consolidated Statements of Operations.

We recorded an expense of $0.3 million and $1.1 million for vehicle service contract payment plan counterparty contingencies in the third quarter and first nine months of 2012, respectively, compared to $1.3 million and $5.0 million, respectively, for the comparable periods in 2011. The lower expense in 2012 is attributed to a decline in the actual and expected level of cancellations giving rise to potential amounts due from counterparties.

Our estimate of probable incurred losses from vehicle service contract counterparty contingencies requires a significant amount of judgment because a number of factors can influence the amount of loss that we may ultimately incur. These factors include our estimate of future cancellations of vehicle service contracts, our evaluation of collateral that may be available to recover funds due from our counterparties, and our assessment of the amount that may ultimately be collected from counterparties in connection with their contractual obligations. We apply a rigorous process, based upon historical payment plan activity and past experience, to estimate probable incurred losses and quantify the necessary reserves for our vehicle service contract counterparty contingencies, but there can be no assurance that our modeling process will successfully identify all such losses.

In particular, as noted in our Risk Factors included in Part I - Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011, Mepco has had to initiate litigation against certain counterparties, including one of the respective third party insurers, to collect amounts owed to Mepco as a result of those parties' dispute of their contractual obligations to Mepco. Vehicle service contract counterparty receivables totaled $18.8 million at September 30, 2012 compared to $29.3 million at December 31, 2011. The decline in such receivables is due primarily to the receipt (in September 2012) of assets (cash and real estate) from the bankruptcy estate of a former counterparty. In addition, see Note #14 to the Interim Condensed Consolidated Financial Statements included within this report for more information about Mepco's business, certain risks and difficulties we currently face with respect to that business, and reserves we have established (through vehicle service contract counterparty contingencies expense) for losses related to the business.

During the third quarter of 2012 we adopted a plan to close or consolidate several branch offices. We expect that these branch offices will be closed prior to year end 2012. We recorded a $0.9 million write-down of property and equipment in the third quarter of 2012 based on the expected disposal price of these branch offices.

The amortization of intangible assets primarily relates to branch acquisitions and the amortization of the deposit customer relationship value, including core deposit value, which was acquired in connection with those acquisitions. We had remaining unamortized intangible assets of $6.8 million and $7.6 million at September 30, 2012 and December 31, 2011, respectively. See Note #8 to the Interim Condensed Consolidated Financial Statements for a schedule of future amortization of intangible assets.

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The provision for loss reimbursement on sold loans represents our estimate of incurred losses related to mortgage loans that we have sold to investors (primarily Fannie Mae and Freddie Mac). Since we sell mortgage loans without recourse, loss reimbursements only occur in those instances where we have breached a representation or warranty or other contractual requirement related to the loan sale. Historically, loss reimbursements on mortgage loans sold without recourse were very rare. In 2009, we had only one actual loss reimbursement (for $0.06 million). Prior to 2009, we had years in which we incurred no such loss reimbursements. However, our loss reimbursements have increased since 2009. Over the past two years Fannie Mae and Freddie Mac, in particular, have been doing more reviews of mortgage loans where they have incurred or expect to incur a loss and have been more aggressive in pursuing loss reimbursements from the sellers of such mortgage loans. Although we are successful in the vast majority of cases where file reviews are conducted on mortgage loans that we have sold to investors and actual loss reimbursements have been relatively modest, the levels of such file reviews and loss reimbursement requests have increased. As a result, we have established a reserve (which totaled $1.1 million and $1.5 million at September 30, 2012 and December 31, 2011, respectively) for loss reimbursements on sold mortgage loans. This reserve is included in accrued expenses and other liabilities in our Condensed Consolidated Statements of Financial Condition. This reserve is based on an analysis of mortgage loans that we have sold which are further categorized by delinquency status, loan to value, and year of origination. The calculation includes factors such as probability of default, probability of loss reimbursement (breach of representation or warranty) and estimated loss severity. The decline in the reserve during 2012 is primarily due to a reduction in specific reserves (due to fewer pending loss reimbursements). While we believe that the amounts we have accrued for incurred losses on sold loans are appropriate given these analyses, future losses could exceed our current estimate.

The changes in costs (recoveries) related to unfunded lending commitments are primarily impacted by changes in the amounts of such commitments to originate portfolio loans as well as (for commercial loan commitments) the grade (pursuant to our loan rating system) of such commitments. In addition, in the third quarter of 2012, we enhanced our methodology for computing the allowance for loan losses on retail loans (residential mortgage loans and consumer loans). This enhanced methodology uses borrower credit scores and a migration analysis to estimate a probability of default. The entire recovery of $0.5 million related to unfunded lending commitments recorded in the third quarter of 2012 is due to the implementation of this enhanced methodology.

Other non-interest expenses were relatively unchanged between the third quarters of 2012 and 2011, but declined by $1.3 million in the first nine months of 2012 compared to the like period in 2011. This year to date decline principally reflects the first quarter 2012 reversal of a previously established accrual at Mepco that was determined to no longer be necessary.

Income tax expense (benefit). As a result of being in a net operating loss carryforward position, we have established a deferred tax asset valuation allowance against all of our net deferred tax assets. Accordingly, the income tax expense (benefit) related to any income (loss) before income tax is largely being offset by changes in the deferred tax valuation allowance. See Note #10 to the Interim Condensed Consolidated Financial Statements.

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Certain of the capital initiatives detailed below under "Liquidity and capital resources" may trigger an ownership change that would negatively affect our ability to utilize our net operating loss carryforwards and other deferred tax assets in the future. If such an ownership change were to occur, we may suffer higher-than-anticipated tax expense, and consequently lower net income and cash flow, in those future years. As of September 30, 2012, we had federal loss carryforwards of approximately $76.1 million (which includes $0.3 million of federal capital loss carryforwards). Companies are subject to a change of ownership test under Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"), that, if met, would limit the annual utilization of tax losses and credits carrying forward from pre-change of ownership periods, as well as the ability to use certain unrealized built-in losses. Generally, under Section 382, the yearly limitation on our ability to utilize such deductions will be equal to the product of the applicable long-term tax exempt rate (presently 2.80%) and the sum of the values of our common shares and of our outstanding convertible preferred stock, immediately before the ownership change. In addition to limits on the use of net operating loss carryforwards, our ability to utilize deductions related to bad debts and other losses for up to a five-year period following such an ownership change would also be limited under Section 382, to the extent that such deductions reflect a net loss that was "built-in" to our assets immediately prior to the ownership change. We are presently seeking to limit the size of any future equity offering in order to avoid triggering any Section 382 limitations.

Since we currently have a valuation allowance intended to fully offset these net operating loss carryforwards and most other deferred tax assets, we do not expect these tax rules to cause a material impact to our net income or loss in the near term.

Our actual federal income tax expense (benefit) is different than the amount computed by applying our statutory federal income tax rate to our pre-tax income (loss) primarily due to tax-exempt interest income and tax-exempt income from the increase in the cash surrender value on life insurance, as well as the impact of the change in the deferred tax asset valuation allowance.

Business Segments. Our reportable segments are based upon legal entities. We currently have two reportable segments: Independent Bank and Mepco. These business segments are also differentiated based on the products and services provided. We evaluate performance based principally on net income (loss) of the respective reportable segments.

The following table presents net income (loss) by business segment.

Business Segments

	Three months ended September 30,		Nine months ended September 30	
	2012	2011	2012	2011
	(in thousands)			
Independent Bank	$7,125	$ (3,164)	$15,726	$ (9,097)
Mepco	268	(96)	1,517	(678)
Other(1)	(923)	(838)	(2,889)	(1,640)
Elimination	(24)	(24)	(71)	(71)
Net income (loss)	$6,446	$ (4,122)	$14,283	$ (11,486)

(1) Includes amounts relating to our parent company and certain insignificant operations.

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The improvement in the results of operations of Independent Bank in 2012 compared to 2011 is primarily due to a lower provision for loan losses, an increase in non-interest income and a decrease in non-interest expenses that were partially offset by a decline in net interest income. (See “Provision for loan losses,” “Portfolio Loans and asset quality,” “Net interest income,” “Non-interest income,” and “Non-interest expense.”)

The change in Mepco’s results is due to a decline in non-interest expenses that was partially offset by a decrease in net interest income that is due principally to a decline in payment plan receivables (see “Net interest income” and “Non-interest expense”). All of Mepco’s funding is provided by Independent Bank through an intercompany loan (that is eliminated in consolidation). The rate on this intercompany loan is based on the Prime Rate (currently 3.25%). Mepco might not be able to obtain such favorable funding costs on its own in the open market.

The change in other in the table above (increased loss of $0.1 million and $1.2 million in the third quarter and first nine months of 2012, respectively, as compared to 2011) is due primarily to the change in the fair value of the amended warrant issued to the UST in each respective period (see “Non-interest income”).

Financial Condition

Summary. Our total assets increased by $93.4 million during the first nine months of 2012 due primarily to increases in cash and cash equivalents and in securities available for sale. Loans, excluding loans held for sale ("Portfolio Loans"), totaled $1.43 billion at September 30, 2012, down 9.2% from $1.58 billion at December 31, 2011. (See "Portfolio Loans and asset quality").

Deposits (including deposits held for sale related to the pending Branch Sale) totaled $2.17 billion at September 30, 2012, compared to $2.09 billion at December 31, 2011. This increase is primarily due to growth in checking and savings account balances. Other borrowings totaled $17.7 million at September 30, 2012, a decrease of $15.7 million from December 31, 2011. This decrease primarily reflects reduced borrowings from the Federal Home Loan Bank of Indianapolis.

Securities. We maintain diversified securities portfolios, which include obligations of U.S. government-sponsored agencies, securities issued by states and political subdivisions, residential mortgage-backed securities and trust preferred securities. We regularly evaluate asset/liability management needs and attempt to maintain a portfolio structure that provides sufficient liquidity and cash flow. Except as discussed below, we believe that the unrealized losses on securities available for sale are temporary in nature and are expected to be recovered within a reasonable time period. We have the ability to hold securities with unrealized losses to maturity or until such time as the unrealized losses reverse. (See “Asset/liability management.”)

Securities

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)			
Securities available for sale				
September 30, 2012	$230,980	$1,980	$2,774	$230,186
December 31, 2011	161,023	1,575	5,154	157,444

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Securities available for sale increased during the first nine months of 2012 due primarily to the purchase of U.S. government-sponsored agency residential mortgage-backed securities, U.S. government-sponsored agency structured notes and obligations of states and political subdivisions. The securities were purchased to utilize some of the funds generated from the continued decline in Portfolio Loans. (See "Deposits" and "Liquidity and capital resources.")

Our portfolio of available-for-sale securities is reviewed quarterly for impairment in value. In performing this review, management considers (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, (3) the impact of changes in market interest rates on the market value of the security and (4) an assessment of whether we intend to sell, or it is more likely than not that we will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. For securities that do not meet these recovery criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income or loss.

We recorded net other than temporary impairment charges on securities of $0.1 million and $0.004 million in the third quarters of 2012 and 2011, respectively. We recorded net other than temporary impairment charges on securities of $0.3 million and $0.1 million in the first nine months of 2012 and 2011, respectively. In these instances we believe that the decline in value is directly due to matters other than changes in interest rates, are not expected to be recovered within a reasonable timeframe based upon available information and are therefore other than temporary in nature. These net other than temporary impairment charges are all related to private label residential mortgage-backed securities. (See "Non-interest income" and "Asset/liability management.")

Sales of securities were as follows (See "Non-interest income."):

	Nine months ended September 30,	
	2012	2011
	(In thousands)	
Proceeds	$ 37,176	$ 70,322
Gross gains	$ 1,193	$ 279
Gross losses	-	(75)
Net impairment charges	(332)	(146)
Fair value adjustments	(39)	67
Net gains	$ 822	$ 125

Portfolio Loans and asset quality. In addition to the communities served by our Bank branch network, our principal lending markets also include nearby communities and metropolitan areas. Subject to established underwriting criteria, we also historically participated in commercial lending transactions with certain non-affiliated banks and also purchased mortgage loans from third-party originators. Currently, we are not engaging in any new commercial loan participations with non-affiliated banks or purchasing any mortgage loans from third party originators.

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The senior management and board of directors of our Bank retain authority and responsibility for credit decisions and we have adopted uniform underwriting standards. Our loan committee structure and the loan review process attempt to provide requisite controls and promote compliance with such established underwriting standards. There can be no assurance that the aforementioned lending procedures and the use of uniform underwriting standards will prevent us from the possibility of incurring significant credit losses in our lending activities and, in fact, we recorded a significant provision for loan losses over the past five years as compared to prior historical levels, although provision levels have been declining since 2009.

We generally retain loans that may be profitably funded within established risk parameters. (See "Asset/liability management.") As a result, we may hold adjustable-rate and balloon mortgage loans as Portfolio Loans, while 15- and 30-year, fixed-rate obligations are generally sold to mitigate exposure to changes in interest rates. (See "Non-interest income.")

Future growth of overall Portfolio Loans is dependent upon a number of competitive and economic factors. Although economic conditions have generally improved in Michigan over the past two years, overall loan demand has remained somewhat subdued, reflecting still somewhat weak economic conditions in the State. Further, it is our desire to reduce certain loan categories in order to preserve our regulatory capital ratios or for risk management reasons. For example, construction and land development loans have been declining because we are seeking to shrink this portion of our Portfolio Loans due to a generally poor economic climate for real estate development, particularly residential real estate. In addition, payment plan receivables have declined as we seek to reduce Mepco's vehicle service contract payment plan business. Further declines in Portfolio Loans may continue to adversely impact our future net interest income.

Non-performing assets(1)

	September 30, 2012		December 31, 2011	
	(Dollars in thousands)			
Non-accrual loans	$ 38,785		$ 59,309	
Loans 90 days or more past due and still accruing interest	62		574	
Total non-performing loans	38,847		59,883	
Other real estate and repossessed assets	30,347		34,042	
Total non-performing assets	$ 69,194		$ 93,925	
As a percent of Portfolio Loans				
Non-performing loans	2.71	%	3.80	%
Allowance for loan losses	3.35		3.73	
Non-performing assets to total assets	2.88		4.07	
Allowance for loan losses as a percent of non-performing loans	123.62		98.33	

(1) Excludes loans classified as "troubled debt restructured" that are not past due and vehicle service contract counterparty receivables, net.

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Troubled debt restructurings (“TDR”)

	September 30, 2012		
	Commercial	Retail	Total
		(In thousands)	
Performing TDR’s	$ 44,061	$ 88,441	$ 132,502
Non-performing TDR’s (1)	10,738	9,237 (2)	19,975
Total	$ 54,799	$ 97,678	$ 152,477

	December 31, 2011		
	Commercial	Retail	Total
		(In thousands)	
Performing TDR’s	$ 29,799	$ 86,770	$ 116,569
Non-performing TDR’s (1)	14,567	14,081 (2)	28,648
Total	$ 44,366	$ 100,851	$ 145,217

(1) Included in non-performing loans in the “Non-performing assets” table above.
(2) Also includes loans on non-accrual at the time of modification until six payments are received on a timely basis.

Non-performing loans declined by $21.0 million, or 35.1%, during the first nine months of 2012 due principally to declines in non-performing commercial loans and residential mortgage loans. These declines primarily reflect loan net charge-offs, pay-offs, negotiated transactions, and the migration of loans into ORE. Non-performing commercial loans relate largely to delinquencies caused by cash-flow difficulties encountered by owners of income-producing properties (due to higher vacancy rates and/or lower rental rates). Non-performing residential mortgage loans are primarily due to delinquencies reflecting both somewhat still weak economic conditions and soft real estate values in many parts of Michigan and in certain markets where we have mortgage loans secured by resort properties (see Note #4 to the Interim Condensed Consolidated Financial Statements). Non-performing loans exclude performing loans that are classified as troubled debt restructurings (“TDRs”). Performing TDRs totaled $132.5 million, or 9.3% of total Portfolio Loans, and $116.6 million, or 7.4% of total Portfolio Loans, at September 30, 2012 and December 31, 2011, respectively. The increase in the amount of performing TDRs in the first nine months of 2012 primarily reflects an increase in commercial loan TDR’s.

ORE and repossessed assets totaled $30.3 million at September 30, 2012, compared to $34.0 million at December 31, 2011. This decrease is primarily the result of sales and write-downs of ORE being in excess of the migration of non-performing loans secured by real estate into ORE as the foreclosure process is completed and any redemption period expires. High foreclosure rates are evident nationwide, but Michigan has consistently had one of the higher foreclosure rates in the U.S. during the past few years. We believe that this high foreclosure rate is due to both somewhat weak economic conditions and declines in residential real estate values (which has eroded or eliminated the equity that many mortgagors had in their home).

We will place a loan that is 90 days or more past due on non-accrual, unless we believe the loan is both well secured and in the process of collection. Accordingly, we have determined that the collection of the accrued and unpaid interest on any loans that are 90 days or more past due and still accruing interest is probable.

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The ratio of loan net charge-offs to average loans was 1.46% on an annualized basis in the first nine months of 2012 compared to 2.35% in the first nine months of 2011. The $13.4 million decline in loan net charge-offs primarily reflects a decrease of $9.2 million for commercial loans and $3.2 million for mortgage loans. The loan net charge-offs primarily reflect our levels of non-performing loans and collateral liquidation values, particularly on residential real estate or income-producing commercial properties.

Allowance for loan losses	Nine months ended September 30,			
	2012		2011	
	Loans	Unfunded Commitments	Loans	Unfunded Commitments
	(Dollars in thousands)			
Balance at beginning of period	$58,884	$ 1,286	$67,915	$ 1,322
Additions (deduction)				
Provision for loan losses	6,438	-	21,029	-
Recoveries credited to allowance	4,603	-	3,080	-
Loans charged against the allowance	(21,294)	-	(33,204)	-
Reclassification to loans held for sale	(610)	-	-	-
Additions (deductions) included in non-interest expense	-	(597)	-	12
Balance at end of period	$48,021	$ 689	$58,820	$ 1,334
Net loans charged against the allowance to average Portfolio Loans (annualized)	1.46%		2.35%	

Allocation of the Allowance for Loan Losses

	September 30, 2012	December 31, 2011
	(In thousands)	
Specific allocations	$ 23,059	$ 22,299
Other adversely rated commercial loans	2,750	4,430
Historical loss allocations	13,643	20,682
Additional allocations based on subjective factors	8,569	11,473
Total	$ 48,021	$ 58,884

Some loans will not be repaid in full. Therefore, an allowance for loan losses ("AFLL") is maintained at a level which represents our best estimate of losses incurred. In determining the allowance and the related provision for loan losses, we consider four principal elements: (i) specific allocations based upon probable losses identified during the review of the loan portfolio, (ii) allocations established for other adversely rated loans, (iii) allocations based principally on historical loan loss experience, and (iv) additional allowances based on subjective factors, including local and general economic business factors and trends, portfolio concentrations and changes in the size and/or the general terms of the loan portfolios.

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The first AFLL element (specific allocations) reflects our estimate of probable incurred losses based upon our systematic review of specific loans. These estimates are based upon a number of objective factors, such as payment history, financial condition of the borrower, discounted collateral exposure and discounted cash flow analysis. Impaired commercial, mortgage and installment loans are allocated allowance amounts using this first element. The second AFLL element (other adversely rated commercial loans) reflects the application of our loan rating system. This rating system is similar to those employed by state and federal banking regulators. Commercial loans that are rated below a certain predetermined classification are assigned a loss allocation factor for each loan classification category that is based upon a historical analysis of both the probability of default and the expected loss rate ("loss given default"). The lower the rating assigned to a loan or category, the greater the allocation percentage that is applied. The third AFLL element (historical loss allocations) is determined by assigning allocations to higher rated ("non-watch credit") commercial loans using a probability of default and loss given default similar to the second AFLL element and to homogenous mortgage and installment loan groups based upon borrower credit score and portfolio segment. For homogenous mortgage and installment loans a probability of default for each homogenous pool is calculated by way of credit score migration. Historical loss data for each homogenous pool coupled with the associated probability of default is utilized to calculate an expected loss allocation rate. The fourth AFLL element (additional allocations based on subjective factors) is based on factors that cannot be associated with a specific credit or loan category and reflects our attempt to ensure that the overall allowance for loan losses appropriately reflects a margin for the imprecision necessarily inherent in the estimates of expected credit losses. We consider a number of subjective factors when determining this fourth element, including local and general economic business factors and trends, portfolio concentrations and changes in the size, mix and the general terms of the overall loan portfolio.

Increases in the AFLL are recorded by a provision for loan losses charged to expense. Although we periodically allocate portions of the AFLL to specific loans and loan portfolios, the entire AFLL is available for incurred losses. We generally charge-off commercial, homogenous residential mortgage, and installment loans and payment plan receivables when they are deemed uncollectible or reach a predetermined number of days past due based on product, industry practice and other factors. Collection efforts may continue and recoveries may occur after a loan is charged against the allowance.

While we use relevant information to recognize losses on loans, additional provisions for related losses may be necessary based on changes in economic conditions, customer circumstances and other credit risk factors.

Mepco's allowance for losses is determined in a similar manner as discussed above, and primarily takes into account historical loss experience and other subjective factors deemed relevant to Mepco's payment plan business. Estimated incurred losses associated with Mepco's outstanding vehicle service contract payment plans are included in the provision for loan losses. Mepco recorded a provision of $0.002 million and $0.04 million in the first nine months of 2012 and 2011, respectively, for its provision for loan losses. These lower provision levels are due primarily to declines ($21.4 million and $66.2 million in the first nine months of 2012 and 2011, respectively) in the balance of payment plan receivables. Mepco's allowance for loan losses totaled $0.2 million at both September 30, 2012 and December 31, 2011, respectively. Mepco has established procedures for vehicle service contract payment plan servicing, administration and collections, including the timely cancellation of the vehicle service contract, in order to protect our position in the event of payment default or voluntary cancellation by the customer. Mepco has also established procedures to attempt to prevent and detect fraud since the payment plan origination activities and initial customer contacts are done entirely through unrelated third parties (vehicle service contract administrators and sellers or automobile dealerships). However, there can be no assurance that the aforementioned risk management policies and procedures will prevent us from the possibility of incurring significant credit or fraud related losses in this business segment. The estimated incurred losses described in this paragraph should be distinguished from the possible losses we may incur from counterparties failing to pay their obligations to Mepco. See Note #14 to the Interim Condensed Consolidated Financial Statements included within this report.

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The allowance for loan losses decreased $10.9 million to $48.0 million at September 30, 2012 from $58.9 million at December 31, 2011 and was equal to 3.35% of total Portfolio Loans at September 30, 2012 compared to 3.73% at December 31, 2011. Three of the four components of the allowance for loan losses outlined above declined during the first nine months of 2012. The specific allocations for loan losses increased due principally to an increase in specific reserves on mortgage loans. The allowance for loan losses related to other adversely rated loans decreased from December 31, 2011 to September 30, 2012 due primarily to a 29.8% decrease in the level of such loans. The allowance for loan losses related to historical losses decreased due to lower adjustments for delinquent loans, declines in loan balances and net charge-offs, as well as a refinement in the calculation methodology for this component of the AFLL that was implemented in the third quarter of 2012. This refinement now uses borrower credit scores and a migration analysis to estimate a probability of default as described above. Finally, the allowance for loan losses related to subjective factors decreased due to the improvement in certain economic indicators used in computing this portion of the allowance as well as an overall decline in Portfolio Loans. In addition to the aforementioned changes, the AFLL was reduced by approximately $0.6 million (of which $0.3 million related to historical losses and $0.3 million related to subjective factors) due to loans that were transferred to held for sale as a part of the pending Branch Sale.

Deposits and borrowings. Historically, the loyalty of our customer base has allowed us to price deposits competitively, contributing to a net interest margin that compares favorably to our peers. However, we still face a significant amount of competition for deposits within many of the markets served by our branch network, which limits our ability to materially increase deposits without adversely impacting the weighted-average cost of core deposits.

To attract new core deposits, we have implemented a direct mail account acquisition program as well as branch staff sales training. Our new account acquisition initiatives have historically generated increases in customer relationships. Over the past three to four years we have also expanded our treasury management products and services for commercial businesses and municipalities or other governmental units and have also increased our sales calling efforts in order to attract additional deposit relationships from these sectors. We view long-term core deposit growth as an important objective. Core deposits generally provide a more stable and lower cost source of funds than alternative sources such as borrowings. During the first nine months of 2012, total deposits (including deposits classified as held for sale related to the pending Branch Sale) increased by $84.4 million, or 4.0% due primarily to growth in checking and savings account balances. (See "Liquidity and capital resources.")

During the fourth quarter of 2009 we prepaid our estimated quarterly deposit insurance premium assessments to the FDIC for periods through the fourth quarter of 2012. These estimated quarterly deposit insurance premium assessments were based on projected deposit balances over the assessment periods. The remaining prepaid deposit insurance premium assessments totaled $10.2 million and $12.6 million at September 30, 2012 and December 31, 2011, respectively. The actual expense over the assessment periods may be different from this prepaid amount due to various factors including variances in the estimated compared to the actual assessment base and rates used during each assessment period.

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We have also implemented strategies that incorporate using federal funds purchased, other borrowings and Brokered CDs to fund a portion of our interest earning assets. The use of such alternate sources of funds supplements our core deposits and is a part of our asset/liability management efforts.

Alternative Sources of Funds

	September 30, 2012			December 31, 2011		
	Amount	Average Maturity	Rate	Amount	Average Maturity	Rate
	(Dollars in thousands)					
Brokered CDs(1)	$48,859	0.8 years	1.10 %	$42,279	1.0 years	1.59 %
Fixed rate FHLB advances	17,714	4.8 years	6.38	30,384	3.3 years	3.99
Variable rate FHLB advances(1)	-			3,000	2.3 years	0.51
Total	$66,573	1.9 years	2.51 %	$75,663	2.0 years	2.51 %

(1) Certain of these items have had their average maturity and rate altered through the use of derivative instruments, including pay-fixed interest rate swaps.

Other borrowings, comprised of advances from the Federal Home Loan Bank (the “FHLB”), totaled $17.7 million at September 30, 2012, compared to $33.4 million at December 31, 2011. The decrease in other borrowed funds reflects reduced borrowings from the FHLB.

As described above, we utilize wholesale funding, including FHLB borrowings and Brokered CDs to augment our core deposits and fund a portion of our assets. At September 30, 2012, our use of such wholesale funding sources amounted to approximately $66.6 million, or 3.0% of total funding (deposits and total borrowings, excluding subordinated debentures). Because wholesale funding sources are affected by general market conditions, the availability of such funding may be dependent on the confidence these sources have in our financial condition and operations. The continued availability to us of these funding sources is uncertain, and Brokered CDs may be difficult for us to retain or replace at attractive rates as they mature. Our liquidity may be constrained if we are unable to renew our wholesale funding sources or if adequate financing is not available in the future at acceptable rates of interest or at all. Additionally, we may not have sufficient liquidity to continue to fund new loans, and we may need to liquidate loans or other assets unexpectedly, in order to repay obligations as they mature.

If we fail to remain “well-capitalized” (under federal regulatory standards) we will be prohibited from accepting or renewing Brokered CDs, without the prior consent of the FDIC. At September 30, 2012, we had Brokered CDs of approximately $48.9 million, or 2.3% of total deposits. Of this amount $32.1 million mature during the next twelve months. We currently have ample liquidity in the form of interest-bearing deposits at the FRB or other short-term investments to retire maturing Brokered CDs. As a result, any potential future restrictions on our ability to access Brokered CDs are not expected to adversely impact our business or financial condition.

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We cannot be sure that we will be able to maintain our current level of core deposits. In particular, those deposits that are currently uninsured or those deposits that are in non-interest bearing transaction accounts and have unlimited deposit insurance only through December 31, 2012 (in accordance with provisions in the Dodd-Frank Act), may be particularly susceptible to outflow. At September 30, 2012 we had an estimated $138.2 million of uninsured deposits and an additional $208.7 million of deposits that were in non-interest bearing transaction accounts and fully insured only through December 31, 2012 under the Dodd-Frank Act. A reduction in core deposits would increase our need to rely on wholesale funding sources, at a time when our ability to do so may be more restricted, as described above.

We historically employed derivative financial instruments to manage our exposure to changes in interest rates. We discontinued the active use of derivative financial instruments during 2008, in part, because we could no longer get unsecured credit from our derivatives counterparties. At September 30, 2012, we had remaining one interest-rate swap with an aggregate notional amount of $10.0 million.

Liquidity and capital resources. Liquidity risk is the risk of being unable to timely meet obligations as they come due at a reasonable funding cost or without incurring unacceptable losses. Our liquidity management involves the measurement and monitoring of a variety of sources and uses of funds. Our Condensed Consolidated Statements of Cash Flows categorize these sources and uses into operating, investing and financing activities. We primarily focus our liquidity management on maintaining adequate levels of liquid assets (primarily funds on deposit with the FRB and certain investment securities) as well as developing access to a variety of borrowing sources to supplement our deposit gathering activities and provide funds for purchasing investment securities or originating Portfolio Loans as well as to be able to respond to unforeseen liquidity needs.

Our primary sources of funds include our deposit base, secured advances from the FHLB, a federal funds purchased borrowing facility with another commercial bank, and access to the capital markets (for Brokered CDs).

At September 30, 2012 we had $371.7 million of time deposits that mature in the next twelve months. Historically, a majority of these maturing time deposits are renewed by our customers. Additionally $1.63 billion (including $291.5 million of deposits held for sale related to the pending Branch Sale) of our deposits at September 30, 2012 were in account types from which the customer could withdraw the funds on demand. Changes in the balances of deposits that can be withdrawn upon demand are usually predictable and the total balances of these accounts have generally grown or have been stable over time as a result of our marketing and promotional activities. However, there can be no assurance that historical patterns of renewing time deposits or overall growth or stability in deposits will continue in the future.

In particular, media reports about bank failures have created concerns among depositors at banks throughout the country, including certain of our customers, particularly those with deposit balances in excess of deposit insurance limits. In response, the deposit insurance limit was permanently increased from $100,000 to $250,000 and unlimited deposit insurance is currently provided (only through December 31, 2012) for balances in non-interest bearing demand deposit accounts under provisions in the Dodd-Frank Act. We have proactively sought to provide appropriate information to our deposit customers about our organization in order to retain our business and deposit relationships. Despite the increases in deposit insurance limits and our proactive communications efforts, the potential outflow of deposits remains as a significant liquidity risk, particularly since our past losses and our elevated level of non-performing assets have reduced some of the financial ratings of our Bank that are followed by our larger deposit customers, such as municipalities. The potential outflow of significant amounts of deposits could have an adverse impact on our liquidity and results of operations.

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We have developed contingency funding plans that stress tests our liquidity needs that may arise from certain events such as an adverse change in our financial metrics (for example, credit quality or regulatory capital ratios). Our liquidity management also includes periodic monitoring that measures quick assets (defined generally as short-term assets with maturities less than 30 days and loans held for sale) to total assets; short-term liability dependence and basic surplus (defined as quick assets compared to short-term liabilities). Policy limits have been established for our various liquidity measurements and are monitored on a monthly basis. In addition, we also prepare cash flow forecasts that include a variety of different scenarios.

As a result of the liquidity risks described above and in "Deposits and borrowings" and now the pending Branch Sale, we have generally maintained elevated levels of overnight cash balances in interest-bearing deposits, which totaled $403.6 million and $278.3 million at September 30, 2012 and December 31, 2011, respectively. We expect the pending Branch Sale will require the use of approximately $330 to $340 million of interest bearing deposits or short-term securities available for sale. We believe that we will continue to have adequate liquidity after the Branch Sale despite the reduction in our cash and cash equivalents because of our remaining securities available for sale, our access to secured advances from the FHLB, our ability to issue Brokered CDs and our improved financial metrics.

As described in greater detail below, we are deferring interest on our subordinated debentures and are not currently paying any dividends on our preferred or common stock. Interest on the subordinated debentures can continue to be deferred until the fourth quarter of 2014. Thus, the only use of cash at the parent company at the present time is for operating expenses. Because of the past losses that our Bank has experienced and the Bank's regulatory capital requirements, we do not anticipate that the Bank will be able to pay any dividends up to the parent company for at least through the end of 2012. As a result, the only substantial near term source of cash to our parent company is under an equity line facility that is described below. We believe that the available cash and cash equivalents on hand as well as access to the equity line facility provide sufficient liquidity at the parent company to meet its operating expenses until the fourth quarter of 2014 (at which point the parent company can no longer defer interest on its subordinated debentures).

Effective management of capital resources is critical to our mission to create value for our shareholders. The cost of capital is an important factor in creating shareholder value and, accordingly, our capital structure includes cumulative trust preferred securities and cumulative convertible preferred stock.

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Capitalization

	September 30, 2012	December 31, 2011
	(In thousands)	
Subordinated debentures	$ 50,175	$ 50,175
Amount not qualifying as regulatory capital	(1,507)	(1,507)
Amount qualifying as regulatory capital	48,668	48,668
Shareholders' Equity		
Convertible preferred stock	83,097	79,857
Common stock	250,080	248,950
Accumulated deficit	(203,217)	(214,259)
Accumulated other comprehensive loss	(8,432)	(11,921)
Total shareholders' equity	121,528	102,627
Total capitalization	$ 170,196	$ 151,295

We have four special purpose entities that originally issued $90.1 million of cumulative trust preferred securities. On June 23, 2010, we issued 5.1 million shares of our common stock (having a fair value of approximately $23.5 million on the date of the exchange) in exchange for $41.4 million in liquidation amount of trust preferred securities and $2.3 million of accrued and unpaid interest on such securities. As a result, at September 30, 2012 and December 31, 2011, $48.7 million of cumulative trust preferred securities remained outstanding. These special purpose entities issued common securities and provided cash to our parent company that in turn, issued subordinated debentures to these special purpose entities equal to the trust preferred securities and common securities. The subordinated debentures represent the sole asset of the special purpose entities. The common securities and subordinated debentures are included in our Condensed Consolidated Statements of Financial Condition.

The Federal Reserve Board has issued rules regarding trust preferred securities as a component of the Tier 1 capital of bank holding companies. The aggregate amount of trust preferred securities (and certain other capital elements) are limited to 25 percent of Tier 1 capital elements, net of goodwill (net of any associated deferred tax liability). The amount of trust preferred securities and certain other elements in excess of the limit can be included in Tier 2 capital, subject to restrictions. At the parent company, $43.3 million of these securities qualified as Tier 1 capital at September 30, 2012. Although the Dodd-Frank Act further limited Tier 1 treatment for trust preferred securities, those new limits will not apply to our outstanding trust preferred securities.

The Proposed New Capital Requirements described above, if adopted, would have a significant impact on our capital requirements, and include provisions that would eventually eliminate trust preferred securities as Tier 1 capital.

In December 2008, we issued 72,000 shares of Series A, Fixed Rate Cumulative Perpetual Preferred Stock, with an original liquidation preference of $1,000 per share ("Series A Preferred Stock"), and a warrant to purchase 346,154 shares (at $31.20 per share) of our common stock ("Original Warrant") to the UST in return for $72.0 million under the Troubled Asset Relief Program's Capital Purchase Program. Of the total proceeds, $68.4 million was originally allocated to the Series A Preferred Stock and $3.6 million was allocated to the Original Warrant (included in capital surplus) based on the relative fair value of each. The $3.6 million discount on the Series A Preferred Stock was being accreted using an effective yield method over five years. The accretion had been recorded as part of the Series A Preferred Stock dividend.

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On April 16, 2010, we exchanged the Series A Preferred Stock (including accumulated but unpaid dividends) for 74,426 shares of our Series B Fixed Rate Cumulative Mandatorily Convertible Preferred Stock, with an original liquidation preference of $1,000 per share ("Series B Preferred Stock"). As part of the terms of the exchange agreement, we also agreed to amend and restate the terms of the Original Warrant and issued an Amended and Restated Warrant to purchase 346,154 shares of our common stock at an exercise price of $7.234 per share and expiring on December 12, 2018. The Series B Preferred Stock and the Amended Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933. We did not receive any cash proceeds from the issuance of the Series B Preferred Stock or the Amended Warrant. In general, the terms of the Series B Preferred Stock are substantially similar to the terms of the Series A Preferred Stock that was held by the UST, except that the Series B Preferred Stock is convertible into our common stock. See Note #15 to the Interim Condensed Consolidated Financial Statements included within this report for information about the terms of the Series B Preferred Stock and the Amended and Restated Warrant.

Shareholders' equity applicable to common stock increased to $38.4 million at September 30, 2012 from $22.8 million at December 31, 2011 due primarily to our net income during the first nine months of 2012. Our tangible common equity ("TCE") totaled $31.6 million and $15.2 million, respectively, at those same dates. Our ratio of TCE to tangible assets was 1.32% at September 30, 2012 compared to 0.66% at December 31, 2011. Although our Bank's regulatory capital ratios remain at levels above "well capitalized" standards, because of the past losses that we have incurred, our elevated levels of non-performing loans and other real estate, and the ongoing economic stress in Michigan, we have taken the following actions to maintain and improve our regulatory capital ratios and preserve liquidity at our parent company level:

- Eliminated the cash dividend on our common stock: Beginning in November 2009, we eliminated the $0.10 per share quarterly cash dividend on our common stock.

- Deferred dividends on our preferred stock: Beginning in December 2009, we suspended payment of quarterly dividends on the preferred stock held by the UST. The cash dividends payable to the UST on the Series B Preferred Stock amount to approximately $4.2 million per year until December of 2013, at which time they would increase to approximately $7.6 million per year. Accrued and unpaid dividends were $9.7 million at September 30, 2012.

- Deferred dividends on our subordinated debentures: Beginning in December 2009, we exercised our right to defer all quarterly interest payments on the subordinated debentures we issued to our trust subsidiaries. As a result, all quarterly dividends on the related trust preferred securities were also deferred. Based on current dividend rates, the cash dividends on all outstanding trust preferred securities as of September 30, 2012, amount to approximately $2.3 million per year. Accrued and unpaid dividends on trust preferred securities at September 30, 2012 and December 31, 2011 were $6.0 million and $4.4 million, respectively.

- Exchanged the Series A Preferred Stock held by the UST for Series B Preferred Stock: In April 2010, we completed the exchange of Series A Preferred Stock held by the UST (plus accrued and unpaid dividends on such stock) for new shares of convertible Series B Preferred Stock, as described above.

- Exchanged certain trust preferred securities for our common stock: In June 2010, we completed the exchange of 5.1 million shares of our common stock for $41.4 million in liquidation amount of trust preferred securities and $2.3 million of accrued and unpaid interest on such securities.

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- Branch Sale: As described above, on May 23, 2012 we executed a definitive agreement to sell 21 branches. This transaction is expected to close prior to year-end 2012 and will significantly increase our regulatory capital ratios.

Many of these actions have preserved cash at our parent company as we do not expect our Bank to be able to pay any cash dividends in the near term. Dividends from the Bank are restricted by federal and state law and are further restricted by the board resolutions adopted in December 2009 (as subsequently amended) and by the Memorandum of Understanding ("MOU") described in Note #11 to the Interim Condensed Consolidated Financial Statements included within this report. In particular, those resolutions and the MOU prohibit the Bank from paying any dividends to the parent company without the prior written approval of the FRB and the Michigan Office of Financial and Insurance Regulation ("OFIR"). Also see "Regulatory development."

Our parent company is also currently prohibited from paying any dividends on our common stock or the convertible preferred stock held by the UST or any distributions on our trust preferred securities. Although there are no specific regulations restricting dividend payments by bank holding companies (other than state corporate laws) the FRB, our primary federal regulator, has issued a policy statement on cash dividend payments. The FRB's view is that: "an organization experiencing earnings weaknesses or other financial pressures should not maintain a level of cash dividends that exceeds its net income, that is inconsistent with the organization's capital position, or that can only be funded in ways that may weaken the organization's financial health." Moreover, the resolutions adopted by our Board in 2009 and the MOU referenced above specifically prohibit the parent company from paying any dividends on our common stock or the preferred stock held by the UST or any distributions on our trust preferred securities without, in each case, the prior written approval of the FRB and the OFIR.

Payment of dividends and distributions on the outstanding common stock, convertible preferred stock, and trust preferred securities is also restricted and governed by the terms of those instruments, as follows:

The terms of the subordinated debentures and trust indentures (the "Indentures") related to our trust preferred securities allow us to defer payment of interest at any time or from time to time for up to 20 consecutive quarters provided no event of default (as defined in the Indentures) has occurred and is continuing. We are not in default with respect to the Indentures, and the deferral of interest does not constitute an event of default under the Indentures. While we defer the payment of interest, we will continue to accrue the interest expense owed at the applicable interest rate. Upon the expiration of the deferral, all accrued and unpaid interest is due and payable. During the deferral period on the Indentures, we may not declare or pay any dividends or distributions on, or redeem, purchase, acquire or make a liquidation payment with respect to, any of our capital stock.

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So long as any shares of the Series B Preferred Stock remain outstanding, unless all accrued and unpaid dividends for all prior dividend periods have been paid or are contemporaneously declared and paid in full, (a) no dividend may be paid or declared on our common stock or other junior stock, other than a dividend payable solely in common stock and other than certain dividends or distributions of rights in connection with a shareholders' rights plan; and (b) with limited exceptions, neither we nor any of our subsidiaries may purchase, redeem or otherwise acquire for consideration any shares of our common stock or other junior stock unless we have paid in full all accrued dividends on the Series B Preferred Stock for all prior dividend periods.

We do not have any current plans to resume interest payments on our outstanding trust preferred securities or dividend payments on the outstanding shares of any convertible preferred stock or common stock. We do not know if or when any such payments will resume. However, as described in Note #11 to the Interim Condensed Consolidated Financial Statements included within this report, our Board adopted a Joint Revised Capital Plan (the "Capital Plan") in November 2011 (as subsequently amended in February 2012). The primary objective of our Capital Plan is to achieve and thereafter maintain the minimum capital ratios required by the December 2009 board resolutions referenced above (as subsequently amended).

As of September 30, 2012, our Bank continued to meet the requirements to be considered "well-capitalized" under federal regulatory standards and has also achieved one of the two minimum capital ratios established by our Board (that are higher than the ratios required in order to be considered "well-capitalized" under federal standards). The Board imposed these higher ratios in order to ensure that we have sufficient capital to withstand potential future losses based on our elevated level of non-performing assets and given certain other risks and uncertainties we face. Set forth below are the actual capital ratios of our Bank as of September 30, 2012, the minimum capital ratios imposed by the board resolutions, and the minimum ratios necessary to be considered "well-capitalized" under federal regulatory standards.

Regulatory Capital Ratios	Independent Bank Actual at September 30, 2012		Minimum Ratios Established by our Board		Required to be Well-Capitalized	
Tier 1 capital to average total assets	7.29	%	8.00	%	5.00	%
Total capital to risk-weighted assets	13.22		11.00		10.00	

The Capital Plan includes projections that reflect forecasted financial data through 2014. At the present time, based on these forecasts and our expectations, we believe that our Bank can remain above "well-capitalized" for regulatory purposes and meet the minimum capital ratios established by our Board, even without additional capital, primarily because of the impact of the pending Branch Sale as well as some further projected decline in total assets (principally loans). Further, credit costs have abated sufficiently so that we have returned to profitability in the first nine months of 2012. These forecasts are susceptible to significant variations, particularly if the Michigan economy were to further deteriorate and credit costs were to be higher than anticipated or if we incur any significant future losses at Mepco related to the collection of vehicle service contract counterparty receivables (see "Non-interest expense"). Because of such uncertainties, it is possible that our Bank may not be able to remain well-capitalized as we work through asset quality issues and seek to return to consistent profitability. Any significant deterioration in or inability to improve our capital position would make it very difficult for us to withstand future losses that we could incur and that may be increased or made more likely as a result of continued economic difficulties and other factors. Please see page 1 of this report for cautionary information about these forward-looking statements and factors that may cause actual results to differ from our current expectations.

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Our Capital Plan also outlines various contingency plans in case we do not succeed in meeting the required minimum capital ratios. These contingency plans include a possible further reduction in our assets (such as through another sale of branches, loans, and/or operating divisions or subsidiaries), more significant expense reductions than those that have already been implemented, and a sale of the Bank. These contingency plans were considered and included within the Capital Plan in recognition of the possibility that market conditions for these transactions may improve and that such transactions may be necessary or required by our regulators if we are unable to attain the required minimum capital ratios described above through other means.

In addition to the measures outlined in the Capital Plan, on July 7, 2010 we executed an Investment Agreement and Registration Rights Agreement with Dutchess Opportunity Fund, II, LP (“Dutchess”) for the sale of shares of our common stock. These agreements serve to establish an equity line facility as a contingent source of liquidity at the parent company level. Pursuant to the Investment Agreement, Dutchess committed to purchase up to $15.0 million of our common stock over a 36-month period ending November 1, 2013. We have the right, but no obligation, to draw on this equity line facility from time to time during such 36-month period by selling shares of our common stock to Dutchess. The sales price is at a 5% discount to the market price of our common stock at the time of the draw (as such market price is determined pursuant to the terms of the Investment Agreement). To date, we have sold a total of 967,549 shares (including 22,340 shares in the third quarter of 2012) of our common stock to Dutchess under this equity line for total net proceeds of approximately $2.4 million. At the present time, we have shareholder approval to sell approximately 3.0 million additional shares under this equity line.

Our bank holding company and our Bank both remain “well capitalized” (as defined by banking regulations) at September 30, 2012.

Asset/liability management. Interest-rate risk is created by differences in the cash flow characteristics of our assets and liabilities. Options embedded in certain financial instruments, including caps on adjustable-rate loans as well as borrowers’ rights to prepay fixed-rate loans, also create interest-rate risk.

Our asset/liability management efforts identify and evaluate opportunities to structure our statement of financial condition in a manner that is consistent with our mission to maintain profitable financial leverage within established risk parameters. We evaluate various opportunities and alternate asset/liability management strategies carefully and consider the likely impact on our risk profile as well as the anticipated contribution to earnings. The marginal cost of funds is a principal consideration in the implementation of our asset/liability management strategies, but such evaluations further consider interest-rate and liquidity risk as well as other pertinent factors. We have established parameters for interest-rate risk. We regularly monitor our interest-rate risk and report at least quarterly to our board of directors.

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We employ simulation analyses to monitor our interest-rate risk profile and evaluate potential changes in our net interest income and market value of portfolio equity that result from changes in interest rates. The purpose of these simulations is to identify sources of interest-rate risk inherent in our Statement of Financial Condition. The simulations do not anticipate any actions that we might initiate in response to changes in interest rates and, accordingly, the simulations do not provide a reliable forecast of anticipated results. The simulations are predicated on immediate, permanent and parallel shifts in interest rates and generally assume that current loan and deposit pricing relationships remain constant. The simulations further incorporate assumptions relating to changes in customer behavior, including changes in prepayment rates on certain assets and liabilities.

Changes in Market Value of Portfolio Equity and Net Interest Income

Change in Interest Rates	Market Value Of Portfolio Equity(1)	Percent Change	Net Interest Income(2)	Percent Change
	(Dollars in thousands)			
September 30, 2012				
200 basis point rise	$272,600	33.76 %	$87,500	9.51 %
100 basis point rise	242,100	18.79	83,300	4.26
Base-rate scenario	203,800	-	79,900	-
100 basis point decline	168,800	(17.17)	78,900	(1.25)
December 31, 2011				
200 basis point rise	$277,500	26.08 %	$91,200	6.17 %
100 basis point rise	252,200	14.58	88,200	2.68
Base-rate scenario	220,100	-	85,900	-
100 basis point decline	181,700	(17.45)	85,000	(1.05)

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(1) Simulation analyses calculate the change in the net present value of our assets and liabilities, including debt and related financial derivative instruments, under parallel shifts in interest rates by discounting the estimated future cash flows using a market-based discount rate. Cash flow estimates incorporate anticipated changes in prepayment speeds and other embedded options.

(2) Simulation analyses calculate the change in net interest income under immediate parallel shifts in interest rates over the next twelve months, based upon a static statement of financial condition, which includes debt and related financial derivative instruments, and do not consider loan fees.

Accounting standards update. See Note #2 to the Interim Condensed Consolidated Financial Statements included elsewhere in this report for details on recently issued accounting pronouncements and their impact on our financial statements.

Fair valuation of financial instruments. Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") topic 820 - "Fair Value Measurements and Disclosures" ("FASB ASC topic 820") defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

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We utilize fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. FASB ASC topic 820 differentiates between those assets and liabilities required to be carried at fair value at every reporting period (“recurring”) and those assets and liabilities that are only required to be adjusted to fair value under certain circumstances (“nonrecurring”). Trading securities, securities available-for-sale, loans held for sale, and derivatives are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a nonrecurring basis, such as loans held for investment, capitalized mortgage loan servicing rights and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or fair value accounting or write-downs of individual assets. See Note #12 to the Interim Condensed Consolidated Financial Statements included within this report for a complete discussion on our use of fair valuation of financial instruments and the related measurement techniques.

Regulatory developments. On October 25, 2011, the respective Boards of Directors of the Company and the Bank entered into an MOU with the FRB and OFIR. The MOU largely duplicates certain of the provisions in the Board resolutions described above, but also has the following specific requirements:

Submission of a joint revised capital plan by November 30, 2011 to maintain sufficient capital at the Company on a consolidated basis and at the Bank on a stand-alone basis;
Submission of quarterly progress reports regarding disposition plans for any assets in excess of $1.0 million that are in ORE, are 90 days or more past due, are on our “watch list,” or were adversely classified in our most recent examination;
Enhanced reporting and monitoring at Mepco regarding risk management and the internal classification of assets; and
Enhanced interest rate risk modeling practices.

We believe that we are generally in compliance with the provisions of the MOU, however we must still close the Branch Sale, which is one of the strategies outlined in the Capital Plan.

Management plans and expectations. Elevated credit costs, including our provision for loan losses, loan and collection costs, net losses on ORE, and losses related to vehicle service contract counterparty contingencies, resulted in substantial losses over the period from 2008 through 2011 and reduced our capital. Management continues to focus on reducing non-performing assets and continuing the profitability that has been achieved in 2012. Further, as discussed above, we have adopted a Capital Plan, which includes a series of actions designed to increase our regulatory capital ratios, decrease our expenses and enable us to withstand and better respond to current market conditions and the potential for worsening market conditions. At the present time, based on our current forecasts and expectations, we believe that our Bank can remain above “well-capitalized” for regulatory purposes for the foreseeable future, even without additional capital, primarily because of the impact of the pending Branch Sale, some projected further decline in total assets (principally loans) and a return to profitability in 2012 and beyond. As a result of these expectations with respect to the Bank’s regulatory capital ratios, and in light of our improvements in asset quality and other positive indicators, we continue to evaluate our alternatives in connection with the timing and size of any common stock offering. This evaluation will take into account our ongoing operating results, as well as input from our financial advisors and the UST.

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Litigation Matters

We are involved in various litigation matters in the ordinary course of business. At the present time, we do not believe any of these matters will have a significant impact on our consolidated financial position or results of operations. The aggregate amount we have accrued for losses we consider probable as a result of these litigation matters is immaterial. However, because of the inherent uncertainty of outcomes from any litigation matter, we believe it is reasonably possible we may incur losses in addition to the amounts we have accrued. At this time, we estimate the maximum amount of additional losses that are reasonably possible is approximately $0.4 million. However, because of a number of factors, including the fact that certain of these litigation matters are still in their early stages and involve claims for which, at this point, we believe have little to no merit, this maximum amount may change in the future.

The litigation matters described in the preceding paragraph primarily include claims that have been brought against us for damages, but do not include litigation matters where we seek to collect amounts owed to us by third parties (such as litigation initiated to collect delinquent loans or vehicle service contract counterparty receivables). These excluded, collection-related matters may involve claims or counterclaims by the opposing party or parties, but we have excluded such matters from the disclosure contained in the preceding paragraph in all cases where we believe the possibility of us paying damages to any opposing party is remote. Risks associated with the likelihood that we will not collect the full amount owed to us, net of reserves, are disclosed elsewhere in this report.

Critical Accounting Policies

Our accounting and reporting policies are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. Accounting and reporting policies for other than temporary impairment of investment securities, the allowance for loan losses, originated mortgage loan servicing rights, vehicle service contract payment plan counterparty contingencies, and income taxes are deemed critical since they involve the use of estimates and require significant management judgments. Application of assumptions different than those that we have used could result in material changes in our consolidated financial position or results of operations. There have been no material changes to our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011.

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Item 3.

Quantitative and Qualitative Disclosures about Market Risk

See applicable disclaimers set forth in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 2 under the caption “Asset/liability management.”

Item 4.

Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

With the participation of management, our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a – 15(e) and 15d – 15(e)) for the period ended September 30, 2012, have concluded that, as of such date, our disclosure controls and procedures were effective.

(b) Changes in Internal Controls.

During the quarter ended September 30, 2012, there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2011.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the quarter ended September 30, 2012, the Company sold 22,340 shares of its common stock in a sale not registered under the Securities Act of 1933. These shares were sold on August 27, 2012, to Dutchess Opportunity Fund, II, LP ("Dutchess") pursuant to the Investment Agreement described in Note #15. The shares were sold at a price of $2.70 per share, which represents a 5% discount to the market price of our common stock at the time of the draw; as such market price is determined pursuant to the terms of the Investment Agreement. The Company issued the shares of Common Stock to Dutchess under the Investment Agreement pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933 due to the fact that the offering of the shares was made on a private basis to a single purchaser and in accordance with written guidance of the SEC's Division of Corporation Finance pertaining to equity line facility transactions.

The Company maintains a Deferred Compensation and Stock Purchase Plan for Non-Employee Directors (the "Plan") pursuant to which non-employee directors can elect to receive shares of the Company's common stock in lieu of fees otherwise payable to the director for his or her service as a director. A director can elect to receive shares on a current basis or to defer receipt of the shares, in which case the shares are issued to a trust to be held for the account of the director and then generally distributed to the director after his or her retirement from the Board. Pursuant to this Plan, during the third quarter of 2012, the Company issued 20,970 shares of common stock to non-employee directors on a current basis and 21,578 shares of common stock to the trust for distribution to directors on a deferred basis. The shares were issued on July 1, 2012, at a price of $2.47 per share, representing aggregate consideration to the Company of $0.1 million. The price per share was the consolidated closing bid price per share of the Company's common stock as of the date of issuance, as determined in accordance with NASDAQ Marketplace Rules. The Company issued the shares pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933 due to the fact that the issuance of the shares was made on a private basis pursuant to the Plan.

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The following table shows certain information relating to purchases of common stock for the three-months ended September 30, 2012, pursuant to any share repurchase plans:

Period	Total Number of Shares Purchased		Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan	Remaining Number of Shares Authorized for Purchase Under the Plan
July 2012	2,402	(1)	$ 2.83	-	NA
August 2012	2,520	(1)	2.70	-	NA
September 2012	2,401	(1)	2.83	-	NA
Total	7,323		$ 2.79	-	NA

(1) A portion of the salary payable to our Chief Executive Officer, Michael M. Magee, and to our President, William B. Kessel, is payable in salary stock, which is issued on a bi-weekly basis in connection with our regular pay periods. The shares disclosed in this table are shares withheld from the shares that would otherwise be issued to Mr. Magee and Mr. Kessel in order to satisfy tax withholding obligations.

Item 3b. Defaults Upon Senior Securities

As of September 30, 2012, the Company was in arrears in the aggregate amount of $9.1 million with respect to the Series B Preferred Stock it issued to the U.S. Department of the Treasury as a result of the Company's decision to defer these dividends in the fourth quarter of 2009.

Item 6. Exhibits

(a) The following exhibits (listed by number corresponding to the Exhibit Table as Item 601 in Regulation S-K) are filed with this report:

11. Computation of Earnings Per Share.
31.1 Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
31.2 Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
32.1 Certificate of the Chief Executive Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
32.2 Certificate of the Chief Financial Officer of Independent Bank Corporation pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
101. INS Instance Document
101. SCH XBRL Taxonomy Extension Schema Document
101. CAL XBRL Taxonomy Extension Calculation Linkbase Document
101. DEF XBRL Taxonomy Extension Definition Linkbase Document
101. LAB XBRL Taxonomy Extension Label Linkbase Document
101. PRE XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date	November 9, 2012	By	/s/ Robert N. Shuster Robert N. Shuster, Principal Financial Officer
Date	November 9, 2012	By	/s/ James J. Twarozynski James J. Twarozynski, Principal Accounting Officer

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