

FIRST BUSINESS FINANCIAL SERVICES, INC.

Form 10-K

March 07, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2013

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 001-34095

FIRST BUSINESS FINANCIAL SERVICES, INC.

(Exact name of registrant as specified in its charter)

Wisconsin

(State or other jurisdiction of incorporation or organization)

39-1576570

(I.R.S. Employer Identification No.)

401 Charmany Drive, Madison, WI

(Address of principal executive offices)

53719

(Zip Code)

Registrant's telephone number, including area code: (608) 238-8008

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Common Stock, \$0.01 par value

Common Share Purchase Rights

Name of each exchange on which registered

The NASDAQ Stock Market LLC

The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes No

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Indicate by check mark if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. "

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-accelerated filer Smaller Reporting Company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes " No

The aggregate market value of the common equity held by non-affiliates computed by reference to the closing price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$117.4 million.

As of February 27, 2014, 3,944,795 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III – Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on May 19, 2014 are incorporated by reference into Part III hereof.

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PART I.

Item 1. Business

BUSINESS

General

First Business Financial Services, Inc. (together with all of its subsidiaries, collectively referred to as “Corporation,” “FBFS,” “we,” “us,” or “our”) is a registered bank holding company originally incorporated in 1986 under the laws of the State of Wisconsin and engaged in the commercial banking business through our two wholly-owned bank subsidiaries, First Business Bank (“FBB”), headquartered in Madison, Wisconsin, and First Business Bank-Milwaukee (“FBB-Milwaukee”) and, together with FBB, the “Banks”), headquartered in Brookfield, Wisconsin. All of our operations are conducted through the Banks and certain subsidiaries of FBB. The Banks operate as business banks focusing on delivering a full line of commercial banking products, including commercial loans and commercial real estate loans, and services tailored to meet the specific needs of small- and medium-sized businesses, business owners, executives, professionals and high net worth individuals. The Banks generally target businesses with annual sales between \$2.0 million and \$75.0 million. Because of their focus on business banking, the Banks do not utilize branch networks to attract retail clients and, to supplement their business banking deposit base, the Banks utilize wholesale funding alternatives to fund a portion of their assets. As of December 31, 2013, on a consolidated basis, we had total assets of \$1.269 billion, total deposits of \$1.130 billion and total stockholders’ equity of \$109.3 million.

Our Business Lines

Commercial Lending

We strive to meet the specific commercial-lending needs of small- to medium-sized companies in our target market areas of Wisconsin, primarily through lines of credit for working capital needs and term loans to businesses with annual sales between \$2.0 million and \$75.0 million. Through FBB, we have a strong presence in Madison and its surrounding areas. In 2000, we opened FBB-Milwaukee to take advantage of the strong commercial base located in Milwaukee and the surrounding communities. In 2006, FBB opened a loan production office in Appleton to take advantage of the strong commercial environment in Northeast Wisconsin. Since then, we have opened additional loan production offices in Oshkosh and Green Bay.

Our commercial loans are typically secured by various types of business assets, including inventory, receivables and equipment. We also originate loans secured by commercial real estate, including non-residential owner-occupied commercial facilities, multi-family housing, office buildings, retail centers, and, to a lesser extent, commercial real estate construction loans. In very limited cases, we may originate loans on an unsecured basis. As of December 31, 2013, our commercial real estate and commercial loans, excluding asset-based lending and equipment financing, represented approximately 79.7% of our total gross loans and leases receivable.

Asset-Based Financing

First Business Capital Corp. (“FBCC”), a wholly-owned subsidiary of FBB, is focused on asset based lending to small to medium-sized companies. With its seven sales offices located in six states, FBCC does not limit itself to conducting business in Wisconsin.

FBCC primarily provides revolving lines of credit and term loans for financial and strategic acquisitions (e.g., leveraged or management buyouts), capital expenditures, working capital to support rapid growth, bank debt refinancing, debt restructuring, corporate turnaround strategies and debtor-in-possession financing in the course of

bankruptcy proceedings or the exit therefrom. As a bank-owned, asset-based lender with strong underwriting standards, FBCC is positioned to provide cost-effective financing solutions to companies with annual sales between \$5.0 million and \$50.0 million and do not have the established stable cash flows necessary to qualify for a more traditional commercial lending product. Asset-based lending is generally more profitable than traditional commercial lending. This line of business complements our traditional commercial loan portfolio and provides us with more diverse income opportunities. As of December 31, 2013, our asset-based lending line represented 13.3% of our total gross loan and leases receivable.

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First Business Factors (“FBF”), a division of FBCC, provides factored receivable financing by purchasing accounts receivable from clients on a full recourse basis and advances up to 85% of the purchased receivable. FBF provides competitive rates to clients starting up, seeking growth and needing cash flow support, or currently experiencing financial issues. Factored receivable arrangements typically have contracts of one to two years. Similar to asset-based lending, factoring is generally more profitable than traditional commercial lending, and complements our traditional commercial portfolio. The purchase of the accounts receivable on a full recourse basis mitigates our risk and provides us with more diverse income opportunities. We started this line of business in November 2012 and we believe we will continue to grow this business in the future. The FBF office is located in Chicago, Illinois. As of December 31, 2013, our factored receivable financing line represented 0.1% of our total gross loan and leases receivable.

Equipment Financing

First Business Equipment Finance, LLC (“FBEF”), a wholly-owned subsidiary of FBB, delivers a broad range of equipment finance products, including leases and loans, to address the financing needs of commercial clients in a variety of industries. FBEF’s focus includes manufacturing equipment, industrial assets, construction and transportation equipment, and drilling and oil field equipment, in addition to a wide variety of other commercial equipment. These financings generally range between \$1.0 million and \$10.0 million with terms of 36 to 84 months. We believe that we will continue to grow this business through our existing offices in Wisconsin, Kansas City, Kansas and Denver, Colorado. As of December 31, 2013, our equipment financing business line represented approximately 5.4% of our total gross loans and leases receivable.

Treasury Management Services

The Banks provide comprehensive services for commercial clients to manage their cash and liquidity, including lockbox, accounts receivable collection services, electronic payment solutions, fraud protection, information reporting, reconciliation and data integration solutions. The Banks also offer a variety of deposit accounts and balance optimization solutions. As we continue to seek to diversify our income and increase our non-interest income, we have focused on increasing these services and have emphasized these offerings with new and existing business clients.

Trust and Investment Services

FBB, through its First Business Trust & Investments division, acts as fiduciary and investment manager for individual and corporate clients, creating and executing asset allocation strategies tailored to each client’s unique situation. First Business Trust & Investments has full fiduciary powers and offers trust, estate, financial planning and investment services, acting in a trustee or agent capacity. First Business Trust & Investments also provides brokerage and custody-only services, for which it administers and safeguards assets but does not provide investment advice. At December 31, 2013, First Business Trust & Investments had \$959.0 million of assets under management and administration.

Competition

The Banks encounter strong competition in attracting commercial loan, asset-based finance, equipment finance and deposit clients as well as trust and investment clients. Such competition includes banks, savings institutions, mortgage banking companies, credit unions, finance companies, equipment finance companies, mutual funds, insurance companies, brokerage firms and investment banking firms. The Banks’ market areas include branches of several commercial banks that are substantially larger in terms of loans and deposits. Furthermore, credit unions exempt from income taxes operate in the Banks’ market areas and aggressively price their products and services to a large portion of the market. The Banks also compete with regional and national financial institutions, many of which have greater liquidity, higher lending limits, greater access to capital, more established market recognition and more resources and

collective experience than the Banks. We believe that the strength of our executive management team, the experience and capabilities of our front-line banking professionals, the range and quality of the products that we offer and our emphasis on building long-lasting relationships sets us apart from our competitors.

The following table lists the counties in which the Banks have their main offices as well as certain other information as of June 30, 2013, the most recent data published by the FDIC:

County	Total Number of Banking Organizations	Total Number of Banking Offices	Total Deposits in County (In Thousands)	FBFS Market Share Rank	FBFS Market Share	Deposit Share %
Dane County	40	187	\$ 13,525,864	5	6.97	%
Waukesha County	38	194	\$ 10,153,346	14	2.14	%

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Employees

At December 31, 2013, we had 164 employees equating to 145.4 full-time equivalent employees. We believe that our relationship with our employees is good. At December 31, 2013, none of our employees were represented by a union.

Our Subsidiaries

First Business Bank

FBB is a state bank chartered in 1909 under the name Kingston State Bank. In 1990, FBB relocated its home office to Madison, Wisconsin, opened a banking facility in University Research Park, and began focusing on providing high-quality banking services to small- to medium-sized businesses located in Madison, Wisconsin and the surrounding area. FBB's product lines include commercial loans, commercial real estate loans, equipment loans and leases and treasury management services. FBB offers a variety of deposit accounts and personal loans to business owners, executives, professionals and high net worth individuals. FBB also offers trust and investment services through First Business Trust & Investments, a division of FBB. FBB has three loan production offices in the Northeast Region of Wisconsin serving Appleton, Oshkosh, and Green Bay and their surrounding areas.

FBB has four wholly-owned subsidiaries:

First Business Capital Corp., is an asset-based commercial lending company specializing in providing lines of credit, factored receivable financing and term loans secured by accounts receivable, inventory, equipment and real estate assets, primarily to manufacturers and wholesale distribution companies located predominately in the Midwest. FBCC was established in 1995 and has sales offices in seven states.

First Business Equipment Finance, LLC is a commercial equipment finance company offering a full array of finance and leasing options to commercial clients of which the largest percentage are currently located in Wisconsin. It offers new and replacement equipment loans and leases, debt restructuring, consolidation, and sale-lease-back transactions through its primary banking locations in Wisconsin and business development offices in Kansas City, Kansas and Denver, Colorado.

FBB Real Estate, LLC ("FBBRE") is a limited liability company established for the purpose of holding and liquidating real estate and other assets acquired by FBB through foreclosure or other legal proceedings.

First Madison Investment Corp. ("FMIC") is located in and formed under the laws of the state of Nevada, and was organized for the purpose of managing a portion of FBB's investment portfolio.

As of December 31, 2013, FBB had total gross loans and leases of \$867.0 million, total deposits of \$937.7 million and total stockholders' equity of \$110.8 million.

First Business Bank-Milwaukee

FBB-Milwaukee is a state bank chartered in 2000 in Wisconsin. We formed FBB-Milwaukee to focus on commercial banking in the greater Milwaukee market area. Like FBB, FBB-Milwaukee's product lines include commercial loans, commercial real estate loans and treasury management services for similar sized businesses as those served by FBB. FBB-Milwaukee offers a variety of deposit accounts and personal loans to business owners, executives, professionals and high net worth individuals. FBB-Milwaukee also offers trust and investment services through a trust service office agreement with FBB. FBB-Milwaukee has one wholly-owned subsidiary, FBB-Milwaukee Real Estate, LLC

("FBBMRE"), which is a limited liability company established for the purpose of holding and liquidating real estate and other assets acquired through foreclosure or other legal proceedings.

As of December 31, 2013, FBB-Milwaukee had total loans of \$114.7 million, total deposits of \$197.9 million and total stockholders' equity of \$16.3 million.

FBFS Statutory Trust II

In September 2008, we formed FBFS Statutory Trust II ("Trust II"), a Delaware business trust wholly-owned by FBFS. In 2008, Trust II completed the sale of \$10.0 million of 10.5% fixed rate trust preferred securities. Trust II also issued

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common securities in the amount of \$315,000 to us. Trust II used the proceeds from the offering to purchase \$10.3 million of 10.5% junior subordinated notes issued by us. FBFS has the right to redeem the junior subordinated notes at each interest payment date on or after September 26, 2013. The preferred securities are mandatorily redeemable upon the maturity of the junior subordinated notes on September 26, 2038. FBFS's ownership interest in Trust II has not been consolidated into the financial statements.

Corporate Information

Our principal executive offices are located at 401 Charmany Drive, Madison, Wisconsin 53719 and our telephone number is (608) 238-8008. We maintain an Internet website at www.firstbusiness.com. This Form 10-K and all of our other filings under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are available through that website, free of charge, including copies of our proxy statement, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports, on the date that we file those materials with, or furnish them to, the Securities and Exchange Commission ("SEC"). These filings are also available to the public on the internet at the SEC's website at www.sec.gov. Shareholders may also read and copy any document that we file at the SEC's public reference rooms located at 100 F Street, NE, Washington, DC 20549. Shareholders may call the SEC at 1-800-SEC-0300 for further information on the public reference room.

Our Market Area

Although certain of our business lines are marketed throughout the Midwest and beyond, our primary market areas lie in Wisconsin. Specifically, our three target market areas consist of Madison and Milwaukee, Wisconsin and their surrounding communities, and Northeastern Wisconsin, including Appleton, Green Bay and Oshkosh, Wisconsin and their surrounding communities. Each of our primary markets provides a unique set of economic and demographic characteristics which provide us with a variety of strategic opportunities. A brief description of each of our primary markets is as follows:

Madison

As the capital city of Wisconsin and home of the University of Wisconsin - Madison, our Madison market, specifically Dane County, offers an appealing economic environment populated by a highly educated workforce (more than 45% of the population of Dane County age 25 or older holds a bachelor's degree or higher degree according to the U.S. Census Bureau, as compared to 26% for the State of Wisconsin as a whole). While the economy of the Madison market is driven in large part by the government and education sectors, there is also a diverse array of industries outside of these segments, including significant concentration of insurance companies (one of which, American Family Insurance Group, is a Fortune 500 Company) and agricultural-related industries. Madison is also home to a concentration of research and development related companies, which benefit from the area's strong governmental and academic ties, as well as the University of Wisconsin Hospital, which provides healthcare services to the South Central Wisconsin market.

According to the U.S. Census Bureau, as of April 1, 2010 (the 2010 Census Date), the Madison metropolitan statistical area ("MSA"), consisting of Dane County, Columbia County and Iowa County, had a total population of 568,593 and 229,033 total households. Since 2000, the Madison MSA has experienced population growth of 13%, compared to the State of Wisconsin's population growth rate of 6%. Due to the composition of its workforce and major economic drivers, the Madison area generally experienced fewer adverse economic effects than many other areas of the country during the period of challenging economic conditions in recent years. As of April, 2010, the five-year average median household income level in Dane County - the largest county within the Madison MSA - was \$60,519, which compares favorably to the average median household income levels in the United States and the State of Wisconsin of \$51,914 and \$51,598, respectively. According to preliminary Bureau Labor of Statistics data, as of

December 2013, the unadjusted unemployment rate in the Madison MSA was 4.0% compared to the national unemployment rate of 6.5% and an unemployment rate in the State of Wisconsin of 5.8%. The unemployment rate in the Madison MSA improved 0.7% from December 2012, compared to the improvement in the national and Wisconsin averages, which was 1.1% and 0.8%, respectively over the same period.

Milwaukee

Our Milwaukee market, the primary commercial and industrial hub for Southeastern Wisconsin, provides a diverse economic base, with both a highly skilled labor force and significant manufacturing base. The most prominent economic sectors in the Milwaukee market include manufacturing, financial services, health care, diversified service companies and education. The metropolitan area ranks among the top manufacturing centers in the United States. Milwaukee's percentage of workforce in the manufacturing sector is one of the highest of any MSA. In addition to this strong manufacturing base, Milwaukee is home to several major hospitals, providing health services to the greater Southeastern Wisconsin market, several

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large academic institutions including the University of Wisconsin-Milwaukee and Marquette University, and a wide variety of small- to medium-size firms with representatives in nearly every industrial classification. The Milwaukee area is also the home to six Fortune 500 companies, including Johnson Controls, Inc., Harley Davidson, Inc., Kohl's Corporation, Rockwell Automation, Inc., ManPower Group and Northwestern Mutual.

According to the U.S. Census Bureau, as of April 1, 2010 (the 2010 Census Date), the Milwaukee MSA, consisting of Milwaukee County, Ozaukee County, Washington County, and Waukesha County, had a total population of 1,555,908 and 615,847 total households. Since 2000, the Milwaukee MSA has experienced a population growth of 4%, compared to the State of Wisconsin's population growth rate of 6%. As of April, 2010, the five-year average median household income level in Waukesha County - our primary market within the Milwaukee Area - was \$75,064, which compares favorably to the median household income level averages in the United States and the State of Wisconsin of \$51,914 and \$51,598, respectively. Despite the period of challenging economic conditions in recent years, the Milwaukee area has begun to experience improvement in its general economic climate. As of December 2013, the preliminary unadjusted unemployment rate in the Milwaukee MSA was 6.2%, compared to the national unemployment rate of 6.5% and an unemployment rate in the State of Wisconsin generally of 5.8%. The unemployment rate in the Milwaukee MSA improved 0.7% from December 2012, compared to the improvement in the national and Wisconsin averages, which was 1.1% and 0.8%, respectively, over the same period.

Northeastern Wisconsin

The cities of Appleton, Green Bay, and Oshkosh, Wisconsin serve as the primary population centers in our Northeast Wisconsin market and provide an attractive market to a variety of industries, including transportation, utilities, packaging and diversified services, with the most significant economic drivers being the manufacturing, packaging and paper goods industries. The most significant individual employers in this market include Bemis Company, Inc., a packaging company, and Oshkosh Corporation, a specialty truck manufacturer, each of which is a Fortune 500 company. As the home of the Green Bay Packers NFL franchise, tourism is also a meaningful industry in this market.

According to the U.S. Census Bureau, as of April 1, 2010 (the 2010 Census Date), the three major MSAs in our Northeast Wisconsin market (Appleton, Green Bay and Oshkosh-Neenah) had a total population of 698,901 and total households of 275,674. Since 2000, these MSAs have experienced a population growth of 9%, compared to the State of Wisconsin's population growth rate of 6%. As of April, 2010, the five-year average median household income level in Outagamie County - where our primary loan production office in this region is located - was \$55,914, compared to the median household income level averages in the United States and the State of Wisconsin of \$51,914 and \$51,598, respectively. According to the Bureau of Labor Statistics, as of December 2013, the preliminary unemployment rate in the three major MSAs in this market ranged from 5.1% to 5.3%, compared to the national unemployment rate of 6.5% and an unemployment rate in the State of Wisconsin of 5.8%. These unemployment rates improved 0.8% from December 2012 in all three major MSAs in this market, compared to the improvement in the national and Wisconsin averages, which was 1.1% and 0.8%, respectively, over the same period.

Executive Officers of the Registrant

The following contains certain information about the executive officers of FBFS. There are no family relationships between any directors or executive officers of FBFS.

Corey A. Chambas, age 51, has served as a director of FBFS since July 2002, as Chief Executive Officer since December 2006 and as President since February 2005. He served as Chief Operating Officer of FBFS from February 2005 to September 2006 and as Executive Vice President from July 2002 to February 2005. He served as Chief Executive Officer of FBB from July 1999 to September 2006 and as President of FBB from July 1999 to February 2005. He also currently serves as a director of our subsidiaries FBCC and First Madison Investment Corp. Mr.

Chambas has over 25 years of commercial banking experience. Prior to joining FBFS, he was a Vice President of Commercial Lending with M&I Bank, now known as BMO Harris Bank, in Madison, Wisconsin.

James F. Ropella, age 54, has served as Senior Vice President and Chief Financial Officer of FBFS since September 2000. Mr. Ropella also serves as the Chief Financial Officer of each of the Banks. He also currently serves as a director of our subsidiaries First Madison Investment Corp. and FBB - Milwaukee. Mr. Ropella has over 30 years of experience in finance and accounting, primarily in the banking industry. Prior to joining FBFS, Mr. Ropella was treasurer of a consumer products company. Prior to that, he was Treasurer of Firststar Corporation, now known as U.S. Bancorp. On February 20, 2014, Mr. Ropella announced his plans to retire from his position during the fourth quarter of 2014. In order to ensure a smooth transition, Mr. Ropella will remain in his position at FBFS as we conduct a thorough search for his replacement. We anticipate establishing a longer-term consulting arrangement with Mr. Ropella following his retirement.

Michael J. Losenegger, age 56, has served as Chief Credit Officer of FBFS since May 2011. Mr. Losenegger also serves as the Chief Credit Officer of the Banks. He also currently serves as a director for our subsidiaries First Madison Investment Corp., FBCC and FBEF. Prior to being appointed Chief Credit Officer, Mr. Losenegger served as FBFS's Chief Operating Officer since September 2006. Mr. Losenegger joined FBFS in 2003 and has held various positions with FBB, including Chief Executive Officer, Chief Operating Officer and Senior Vice President of Business Development. Mr. Losenegger has over 25 years of experience in commercial lending. Prior to joining FBFS, Mr. Losenegger was Senior Vice President of Lending at M&I Bank, now known as BMO Harris Bank, in Madison, Wisconsin.

Barbara M. Conley, age 60, has served as FBFS's General Counsel since June 2008 and as Senior Vice President/Corporate Secretary since December 2007. Ms. Conley also serves as General Counsel, Senior Vice President and Corporate Secretary of the Banks. She has also served as a Director of FBCC since June 2009. Ms. Conley has over 30 years of experience in commercial banking. Directly prior to joining FBFS in 2007, Ms. Conley was a Senior Vice President in Corporate Banking with Associated Bank. She had been employed at Associated Bank since May 1976.

Jodi A. Chandler, age 49, has served as Senior Vice President-Human Resources & Administration of FBFS since January 2010. Prior to that, she held the position of Senior Vice President-Human Resources for several years. She has been an employee of FBFS for over 20 years.

Mark J. Meloy, age 52, has served as President and Chief Executive Officer of FBB since December 2007. Mr. Meloy joined FBFS in 2000 and has held various positions including Executive Vice President of FBB and President and Chief Executive Officer of FBB-Milwaukee. He currently serves as CEO of FBEF. He also currently serves as a director of our subsidiaries FBB and FBEF. Mr. Meloy has over 25 years of commercial lending experience. Prior to joining FBFS, Mr. Meloy was a Vice President and Senior Relationship Manager with Firststar Bank, NA, Cedar Rapids, Iowa and Milwaukee, Wisconsin, now known as U.S. Bank, working in their financial institutions group with mergers and acquisition financing.

Joan A. Burke, age 62, has served as President of FBB's Trust Division since September 2001. Ms. Burke has over 30 years of experience in providing trust and investment advice. Prior to joining FBFS, Ms. Burke was the President, Chief Executive Officer and Chairperson of the Board of Johnson Trust Company and certain of its affiliates.

Charles H. Batson, age 60, has served as the President and Chief Executive Officer of FBCC since January 2006. He also serves as a director for FBCC. Mr. Batson has over 30 years of experience in asset-based lending. Directly prior to joining FBCC, Mr. Batson served as Vice President and Business Development Manager for Wells Fargo Business Credit, Inc. since 1990.

David J. Vetta, age 59, has served as President and Chief Executive Officer of FBB-Milwaukee since January 2007. He also serves as a director for FBB-Milwaukee. Prior to joining FBB-Milwaukee, Mr. Vetta was Managing Director at JP Morgan Asset Management since 1992 overseeing National Institutional Investment Sales teams and the Regional Private Client Group, while serving as a member of the executive committee. Mr. Vetta was affiliated with JP Morgan Chase and its predecessor companies in various other roles since 1976.

SUPERVISION AND REGULATION

Below is a brief description of certain laws and regulations that relate to us and the Banks. This narrative does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

General

Financial institutions, their holding companies and their affiliates are extensively regulated under federal and state law. As a result, our growth and earnings performance may be affected not only by management decisions and general

economic conditions, but also by the requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the Division of Banking of the Wisconsin Department of Financial Institutions (the “WDFI”), the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Federal Deposit Insurance Corporation (the “FDIC”) and the Bureau of Consumer Financial Protection (the “CFPB”). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board and securities laws administered by the SEC and state securities authorities have an impact on our business. The effect of these statutes, regulations, regulatory policies and accounting rules are significant to our operations and results, and the nature and

extent of future legislative, regulatory or other changes affecting financial institutions are impossible to predict with any certainty.

Federal and state banking laws impose a comprehensive system of supervision, regulation and enforcement on the operations of financial institutions, their holding companies and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than shareholders. These federal and state laws, and the regulations of the bank regulatory agencies issued under them, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates and the payment of dividends. Moreover, turmoil in the credit markets in recent years prompted the enactment of unprecedented legislation which allowed the U.S. Department of the Treasury (the "Treasury") to make equity capital available to qualifying financial institutions to help restore confidence and stability in the U.S. financial markets. This legislation imposes additional requirements on institutions in which the Treasury has an investment.

This supervisory and regulatory framework subjects banks and bank holding companies to regular examination by their respective regulatory agencies, which results in examination reports and ratings that are not publicly available and that can impact the conduct and growth of their businesses. These examinations consider not only compliance with applicable laws and regulations, but also capital levels, asset quality and risk, management ability and performance, earnings, liquidity, and various other factors. The regulatory agencies generally have broad discretion to impose restrictions and limitations on the operations of a regulated entity where the agencies determine, among other things, that such operations are unsafe or unsound, fail to comply with applicable law or are otherwise inconsistent with laws and regulations or with the supervisory policies of these agencies.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to us and the Banks. It does not describe all of the statutes, regulations and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

Financial Regulatory Reform

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") into law. The Dodd-Frank Act represents a sweeping reform of the U.S. supervisory and regulatory framework applicable to financial institutions and capital markets in the wake of the global financial crisis, certain aspects of which are described below in more detail. In particular, and among other things, the Dodd-Frank Act: (i) created a Financial Stability Oversight Council as part of a regulatory structure for identifying emerging systemic risks and improving interagency cooperation; (ii) created the CFPB, which is authorized to regulate providers of consumer credit, savings, payment and other consumer financial products and services; (iii) narrowed the scope of federal preemption of state consumer laws enjoyed by national banks and federal savings associations and expanded the authority of state attorneys general to bring actions to enforce federal consumer protection legislation; (iv) imposed more stringent capital requirements on bank holding companies and subjected certain activities, including interstate mergers and acquisitions, to heightened capital conditions; (v) with respect to mortgage lending, (a) significantly expanded requirements applicable to loans secured by 1-4 family residential real property, (b) imposed strict rules on mortgage servicing, and (c) required the originator of a securitized loan, or the sponsor of a securitization, to retain at least 5% of the credit risk of securitized exposures unless the underlying exposures are qualified residential mortgages or meet certain underwriting standards; (vi) repealed the prohibition on the payment of interest on business checking accounts; (vii) restricted the interchange fees payable on debit card transactions for issuers with \$10 billion in assets or greater; (viii) prohibited in the so-called "Volcker Rule," subject to numerous exceptions, depository institutions and affiliates from making certain investments in, and sponsorship of, hedge funds and private equity funds and from engaging in proprietary trading; (ix) provided for enhanced regulation of advisers to private funds and of the derivatives markets; (x) enhanced oversight of credit rating agencies; and (xi) prohibited banking agency requirements tied to credit ratings. These statutory changes shifted the regulatory framework for financial institutions, impacted the way in which they do business and have the potential to constrain revenues. Numerous provisions of the Dodd-Frank Act are required to be implemented through rulemaking by the appropriate federal regulatory agencies. Many of the required regulations have been issued and others have been released for

public comment, but there remain a number that have yet to be released in any form. Furthermore, while the reforms primarily target systemically important financial service providers, their influence is expected to filter down in varying degrees to smaller institutions over time. Our management will continue to evaluate the effect of the Dodd-Frank Act changes; however, in many respects, the ultimate impact of the Dodd-Frank Act will not be fully known for years, and no current assurance may be given

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that the Dodd-Frank Act, or any other new legislative changes, will not have a negative impact on the results of operations and financial condition of FBFS and the Banks.

The Increasing Regulatory Emphasis on Capital

Regulatory capital represents the net assets of a financial institution available to absorb losses. Because of the risks attendant to their business, depository institutions are generally required to hold more capital than other businesses, which directly affects earnings capabilities. While capital has historically been one of the key measures of the financial health of both bank holding companies and banks, its role is becoming fundamentally more important in the wake of the global financial crisis, as the banking regulators recognized that the amount and quality of capital held by banks prior to the crisis was insufficient to absorb losses during periods of severe stress. Certain provisions of the Dodd-Frank Act and Basel III, discussed below, establish strengthened capital standards for banks and bank holding companies, require more capital to be held in the form of common stock and disallow certain funds from being included in capital determinations. Once fully implemented, these standards will represent regulatory capital requirements that are significantly more stringent than those in place currently and historically.

FBFS and Bank Required Capital Levels. Bank holding companies have historically had to comply with less stringent capital standards than their bank subsidiaries and were able to raise capital with hybrid instruments such as trust preferred securities. The Dodd-Frank Act mandated the Federal Reserve to establish minimum capital levels for bank holding companies on a consolidated basis that are as stringent as those required for insured depository institutions.

As a consequence, the components of holding company permanent capital known as “Tier 1 Capital” are being restricted to capital instruments that are considered to be Tier 1 Capital for insured depository institutions. A result of this change is that the proceeds of hybrid instruments, such as trust preferred securities, are being excluded from Tier 1 Capital unless such securities were issued prior to May 19, 2010 by bank holding companies with less than \$15 billion of assets, subject to certain restrictions. Because we have assets of less than \$15 billion, we are able to maintain our trust preferred proceeds, subject to certain restrictions, as Tier 1 Capital, but will have to comply with new capital mandates in other respects and will not be able to raise Tier 1 Capital in the future through the issuance of trust preferred securities.

Under current federal regulations, the Banks are subject to the following minimum capital standards:

- a leverage requirement, consisting of a minimum ratio of Tier 1 Capital to total adjusted book assets of 3% for the most highly-rated banks with a minimum requirement of at least 4% for all others, and
- a risk-based capital requirement, consisting of a minimum ratio of Total Capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 Capital to total risk-weighted assets of 4%.

For these purposes, “Tier 1 Capital” consists primarily of common stock, noncumulative perpetual preferred stock and related surplus less intangible assets (other than certain loan servicing rights and purchased credit card relationships). “Total Capital” consists primarily of Tier 1 Capital plus “Tier 2 Capital,” which includes other nonpermanent capital items, such as certain other debt and equity instruments that do not qualify as Tier 1 Capital, and a portion of the Banks’ respective allowance for loan and lease losses. Further, “risk-weighted assets” for the purposes of the risk-weighted ratio calculations are balance sheet assets and off-balance-sheet exposures to which required risk weightings of 0% to 100% are applied.

The capital standards described above are minimum requirements and will be increased under Basel III, as discussed below. Bank regulatory agencies are uniformly encouraging banks and bank holding companies to be “well-capitalized” and, to that end, federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. For example, a banking organization that is “well-capitalized” may: (i) qualify for exemptions from prior notice or application requirements otherwise applicable to certain types of activities; (ii) qualify for expedited processing of other required notices or applications; and (iii) accept brokered deposits. Under the capital regulations of the FDIC and Federal Reserve, in order to be “well capitalized,” a banking organization, under current federal regulations, must maintain:

- a leverage ratio of Tier 1 Capital to total assets of 5% or greater,
- a ratio of Tier 1 Capital to total risk-weighted assets of 6% or greater, and
- a ratio of Total Capital to total risk-weighted assets of 10% or greater.

The FDIC and Federal Reserve guidelines also provide that banks and bank holding companies experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the guide