

PEAPACK GLADSTONE FINANCIAL CORP
Form 10-K
March 16, 2011

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2010

Commission File No. 000-23537

PEAPACK-GLADSTONE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New Jersey
(State or other jurisdiction of
incorporation or organization)

22-2491488
(I.R.S. Employer Identification No.)

500 Hills Drive, Suite 300
Bedminster, NJ
(Address of principal executive offices)

07921
(Zip Code)

Registrant's telephone number (908) 234-0700

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

Title of Each Class
Common Stock, No par value

Name of Exchange on which Registered
NASDAQ Global Select Markets

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 Section 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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if 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 of this Form 10-K

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

The aggregate market value of the shares held by unaffiliated stockholders was approximately \$96,394,227 on June 30, 2010.

As of February 28, 2011, 8,822,700 shares of no par value Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Corporation's 2010 Annual Report to shareholders (the "2010 Annual Report") and Definitive Proxy Statement for the Corporation's 2011 Annual Meeting of Shareholders (the "2011 Proxy Statement") are incorporated by reference into Parts II and III. The Corporation will file the 2011 Proxy Statement within 120 days of December 31, 2010.

FORM 10-K
 PEAPACK-GLADSTONE FINANCIAL CORPORATION
 For the Year Ended December 31, 2010

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This Form 10-K contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are not historical facts and include expressions about management's confidence and strategies and management's expectations about new and existing programs and products, investments, relationships, opportunities and market conditions. These statements may be identified by such forward-looking terminology as "expect", "look", "believe", "anticipate", "may", or similar statements or variations of such terms. Actual results may differ materially from such forward-looking statements. Factors that may cause results to differ materially from such forward-looking statements include, but are not limited to those risks identified in the "Risk Factor" section of this Annual Report on Form 10-K and:

- a continued or unexpected decline in the economy, in particular in our New Jersey market area;
 - declines in value in our investment portfolio;
- higher than expected increases in our allowance for loan losses;
- higher than expected increases in loan losses or in the level of nonperforming loans;
 - unexpected changes in interest rates;
 - inability to successfully grow our business;
 - inability to manage our growth;
- a continued or unexpected decline in real estate values within our market areas;
- legislative and regulatory actions (including the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and related regulations) subject us to additional regulatory oversight which may result in increased compliance costs;
 - higher than expected FDIC insurance premiums;
 - lack of liquidity to fund our various cash obligations;
- repurchase of our preferred shares issued under the Treasury's Capital Purchase Program which will impact net income available to our common shareholders and our earnings per share;
 - reduction in our lower-cost funding sources;
 - our inability to adapt to technological changes;
- claims and litigation pertaining to fiduciary responsibility, environmental laws and other matters; and
 - other unexpected material adverse changes in our operations or earnings.

The Corporation undertakes no duty to update any forward-looking statement to conform the statement to actual results or changes in the Corporation's expectations. Although we believe that the expectations reflected in the forward-looking statements are reasonable, the Corporation cannot guarantee future results, levels of activity, performance or achievements.

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PART I

Item 1.

BUSINESS
The Corporation

Peapack-Gladstone Financial Corporation (the “Corporation”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended (“Holding Company Act”). The Corporation was organized under the laws of New Jersey in August 1997, by the Board of Directors of Peapack-Gladstone Bank (the “Bank”), its principal subsidiary, to become a holding company for the Bank. The Bank is a state chartered commercial bank founded in 1921 under the laws of the State of New Jersey. The Bank is a member of the Federal Reserve System. The Bank offers financial services through 23 full-service banking offices. The Bank maintains ten branches in Somerset County, six in Morris County, four in Hunterdon County, one in Middlesex County and two in Union County.

The Bank is primarily dedicated to providing quality, personalized financial, trust and investment services to individuals and small businesses.

Commercial loan customers of the Bank are business people, including merchants, architects, doctors, dentists, attorneys and building contractors as well as various service firms and other local retailers. Most forms of commercial lending are offered, including working capital lines of credit, term loans for fixed asset acquisitions, commercial mortgages and other forms of asset-based financing.

In addition to commercial lending activities, the Bank offers a wide range of consumer banking services, including: checking and savings accounts, money market and interest-bearing checking accounts, certificates of deposit, and individual retirement accounts held in certificates of deposit. The Bank also offers residential and construction mortgages, home equity lines of credit and other second mortgage loans. For children, the Bank offers a special pony club savings account. New Jersey Consumer Checking Accounts are offered to low income customers. In addition, the Bank provides foreign and domestic travelers' checks, cashier's checks and wire transfers. Automated teller machines are available at 23 locations. Via the automatic teller machine access card issued by the Bank, customers may pay for commodities at point-of-sale merchant locations. Internet banking is available to customers including an online bill payment option. The Corporation has no foreign operations.

The Bank has a Trust and Investment Department, PGB Trust and Investments, which offers personal investment management services, personal trust administration services, estate settlement, income tax services, custodial services and other financial planning services. Since its inception in 1972, market value of trust assets under administration have increased to \$1.94 billion.

The Corporation makes its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to such reports, available free of charge on its website at www.pgbank.com. Also available on the website are the Corporation’s Code of Business Conduct and Ethics, Corporate Governance Principles and charters for the Corporation’s Audit Committee, Compensation Committee and Nominating Committee.

Employees

As of December 31, 2010, the Corporation employed 284 full-time equivalent persons. Management considers relations with employees to be satisfactory.

Principal Market Areas

The Bank's principal market for its deposit gathering activities includes Somerset, Morris, Hunterdon, Middlesex and Union Counties. The area is composed of upper-income single-family homes, moderate-income properties, some low-income housing and several large corporate campuses. There are numerous small retail businesses in each of the towns as well as offices for various professionals, i.e. attorneys, architects, interior decorators, physicians, etc. A portion of the market area is bisected by Interstate Highways 287 and 78 where numerous corporate offices have relocated over the past 25 years.

The Bank has expanded its service areas from one office in 1968 to the present 23 full-service banking locations by steadily opening new branches. Most of the communities that the Bank serves are demographically similar and contiguous to the main office.

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Competition

The market for banking and bank-related services is highly competitive. The Bank competes with other providers of financial services such as other bank holding companies, commercial and savings banks, savings and loan associations, credit unions, money market and mutual funds, mortgage companies, and a growing list of other local, regional and national institutions which offer financial services. Mergers between financial institutions within New Jersey and in neighboring states have added competitive pressure. The Bank competes by offering quality products and convenient services at competitive prices. In order to maintain and enhance its competitive position, the Bank regularly reviews its products, locations and new branching prospects.

Governmental Policies and Legislation

The banking industry is highly regulated. Statutory and regulatory controls increase a bank holding company's cost of doing business and limit the options of its management to deploy assets and maximize income. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial institutions are frequently made in Congress, in state legislatures and before various bank regulatory agencies. The likelihood of any major changes and the impact such changes might have on the Corporation or the Bank is impossible to predict. The following discussion is not intended to be a complete list of all the activities regulated by the banking laws or of the impact of such laws and regulations on the Bank. It is intended only to briefly summarize some material provisions.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") was signed into law on July 21, 2010. Generally, the Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law. The Act, among other things:

- Directs the Federal Reserve to issue rules which are expected to limit debit-card interchange fees;
- After a three-year phase-in period which begins January 1, 2013, removes trust preferred securities as a permitted component of Tier 1 capital for bank holding companies with assets of \$15 billion or more, however, bank holding companies with assets of less than \$15 billion will be permitted to include trust preferred securities that were issued before May 19, 2010 as Tier 1 capital;
- Provides for increases in the minimum reserve ratio for the deposit insurance fund from 1.15 percent to 1.35 percent and changes the basis for determining FDIC premiums from deposits to assets;
- Creates a new Consumer Financial Protection Bureau that will have rulemaking authority for a wide range of consumer protection laws that would apply to all banks and would have broad powers to supervise and enforce consumer protection laws;
- Requires public companies to give shareholders a non-binding vote on executive compensation at their first annual meeting following enactment and at least every three years thereafter and on "golden parachute" payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders;
- Authorizes the SEC to promulgate rules that would allow shareholders to nominate their own candidates using a company's proxy materials;
-

Directs federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of \$1 billion, regardless of whether the company is publicly traded or not;

- Prohibits a depository institution from converting from a state to a federal charter or vice versa while it is the subject of a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter unless the appropriate federal banking agency gives notice of conversion to the federal or state authority that issued the enforcement action and that agency does not object within 30 days;
- Changes standards for Federal preemption of state laws related to federally chartered institutions and their subsidiaries;

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- Provides mortgage reform provisions regarding a customer's ability to repay, requiring the ability to repay for variable-rate loans to be determined by using the maximum rate that will apply during the first five years of the loan term, and making more loans subject to provisions for higher cost loans, new disclosures, and certain other revisions;
- Creates a Financial Stability Oversight Council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity;
- Makes permanent the \$250 thousand limit for federal deposit insurance and provides unlimited federal deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts at all insured depository institutions; and
- Repeals the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transactions and other accounts.
- Authorizes de novo interstate branching, subject to non-discriminatory state rules, such as home office protection.

The Dodd-Frank Act contains numerous other provisions affecting financial institutions of all types, many of which may have an impact on our operating environment in substantial and unpredictable ways. Consequently, the Dodd-Frank Act is likely to increase our cost of doing business, it may limit or expand our permissible activities, and it may affect the competitive balance within our industry and market areas. The nature and extent of future legislative and regulatory changes affecting financial institutions, including as a result of the Dodd-Frank Act, is very unpredictable at this time. Our management is actively reviewing the provisions of the Dodd-Frank Act, many of which are phased-in over time, and assessing its probable impact on our business, financial condition, and results of operations. However, the ultimate effect of the Dodd-Frank Act on the financial services industry in general, and us in particular, is uncertain at this time.

Capital Requirements

The Corporation's wholly owned subsidiary is subject to risk-based capital guidelines for banks as adopted by the Federal Reserve Board. The minimum guideline for the ratio of total capital to risk-weighted assets is 8%. At least half of the total capital is to be comprised of common stock, retained earnings, minority interests in the equity accounts of consolidated subsidiaries, noncumulative perpetual preferred stock and a limited amount of qualifying cumulative perpetual preferred stock, less goodwill and certain other intangibles ("Tier 1 Capital"). The remainder may consist of other preferred stock, certain other instruments and a portion of the loan loss allowance. At December 31, 2010, the Bank's Tier 1 Capital and Total Capital ratios were 12.28% and 13.54%, respectively.

In addition, the Federal Reserve Board has established minimum leverage ratio guidelines for banks. These guidelines provide for a minimum ratio of Tier 1 Capital to average total assets of 3% for banks that meet certain specified criteria, including having the highest regulatory rating. All other banks generally are required to maintain a leverage ratio of at least 3% plus an additional cushion of 100 to 200 basis points. The Bank's leverage ratio at December 31, 2010 was 7.57%.

Basel III

In December 2010, the Basel Committee released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III". Basel III, when implemented by the U.S. banking agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity.

The Basel III final capital framework, among other things, (i) introduces as a new capital measure “Common Equity Tier 1” (“CET1”), (ii) specifies that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting specified requirements, (iii) defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expands the scope of the adjustments as compared to existing regulations.

When fully phased in on January 1, 2019, Basel III requires banks to maintain (i) as a newly adopted international standard, a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is

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added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of Total (that is, Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) as a newly adopted international standard, a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

Basel III also provides for a “countercyclical capital buffer,” generally to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk, that would be a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented (potentially resulting in total buffers of between 2.5% and 5%). The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The implementation of the Basel III final framework will commence January 1, 2013. On that date, banking institutions will be required to meet the following minimum capital ratios:

- 3.5% CET1 to risk-weighted assets.
- 4.5% Tier 1 capital to risk-weighted assets.
- 8.0% Total capital to risk-weighted assets.

The Basel III final framework provides for a number of new deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Implementation of the deductions and other adjustments to CET1 will begin on January 1, 2014 and will be phased-in over a five-year period (20% per year). The implementation of the capital conservation buffer will begin on January 1, 2016 at 0.625% and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

The U.S. banking agencies have indicated informally that they expect to propose regulations implementing Basel III in mid-2011 with final adoption of implementing regulations in mid-2012. Notwithstanding its release of the Basel III framework as a final framework, the Basel Committee is considering further amendments to Basel III, including the imposition of additional capital surcharges on globally systemically important financial institutions. In addition to Basel III, Dodd-Frank requires or permits the Federal banking agencies to adopt regulations affecting banking institutions’ capital requirements in a number of respects, including potentially more stringent capital requirements for systemically important financial institutions. Accordingly, the regulations ultimately applicable to the Corporation may be substantially different from the Basel III final framework as published in December 2010. Requirements to maintain higher levels of capital or to maintain higher levels of liquid assets could adversely impact the Corporation’s net income and return on equity.

Pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), each federal banking agency has promulgated regulations, specifying the levels at which a financial institution would be considered "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized," and to take certain mandatory and discretionary supervisory actions based on the capital level of the institution. The regulations implementing these provisions of FDICIA provide that a bank is defined to be "well capitalized" if it maintains a leverage ratio of at least 5%, a risk-adjusted Tier 1 capital ratio of at least 6% and a risk-adjusted total capital ratio of at least 10% and is not otherwise in a "troubled condition" as specified by its appropriate federal regulatory agency. A bank is defined to be "adequately capitalized" if it meets other minimum capital requirements. In addition, a depository institution will be considered "undercapitalized" if it fails to meet any minimum required measure, "significantly undercapitalized" if it is significantly below such measure and "critically undercapitalized" if it fails to maintain a level of tangible equity equal to not less than 2% of total assets. A depository institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives an unsatisfactory examination rating.

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Insurance Funds Legislation

The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation ("FDIC"). The Deposit Insurance Fund is the successor to the Bank Insurance Fund and the Savings Association Insurance Fund, which were merged in 2006. Under the FDIC's risk-based system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors with less risky institutions paying lower assessments on their deposits.

On November 12, 2009, the FDIC issued a final rule that required insured depository institutions to prepay, on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012, together with their quarterly risk-based assessment for the third quarter 2009. The Bank paid approximately \$8.8 million in assessments as of December 31, 2009 of which approximately \$8.3 million was recorded as a prepaid asset. Prepaid assessments are to be applied against the actual quarterly assessments until exhausted, and may not be applied to any special assessments that may occur in the future. Any unused prepayments will be returned to the Bank on June 30, 2013. The balance of the prepaid FDIC assessment fees at December 31, 2010 was \$6.1 million.

In November 2010, as required by the Dodd Frank Act, the Federal Deposit Insurance Corporation proposed to revise the assessment base to consist of average consolidated total assets during the assessment period minus the average tangible equity during the assessment period. In addition, the proposed revisions would eliminate the adjustment for secured borrowings and make certain other changes to the impact of unsecured borrowings and brokered deposits on an institution's deposit insurance assessment. The proposed rule also revises the assessment rate schedule to provide assessments ranging from 5 to 45 basis points. No assurance can be given as to the final form of the proposed regulations or its impact on the Bank.

As previously noted above, the Dodd-Frank Act makes permanent the \$250 thousand limit for federal deposit insurance and provides unlimited federal deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts at all insured depository institutions.

The FDIC has authority to further increase insurance assessments. A significant increase in insurance premiums may have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what insurance assessment rates will be in the future.

Troubled Asset Relief Capital Purchase Program

In response to the financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the "EESA") was signed into law. Pursuant to the EESA, the U.S. Treasury was given the authority to, among other things, purchase up to \$700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets.

On October 14, 2008, the Secretary of the U.S. Department of the Treasury announced that the Treasury will purchase equity stakes in a wide variety of banks and thrifts. Under the program, known as the Troubled Asset Relief Program Capital Purchase Program (the "TARP Capital Purchase Program"), from the \$700 billion authorized by the EESA, the Treasury made \$250 billion of capital available to U.S. financial institutions in the form of preferred stock. In conjunction with the purchase of preferred stock, the Treasury received, from participating financial institutions, warrants to purchase common stock with an aggregate market price equal to 15% of the preferred investment. Participating financial institutions were required to adopt the Treasury's standards for executive compensation and

corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program.

The Corporation entered into a Securities Purchase Agreement with the Treasury that provides for our participation in the TARP Capital Purchase Program. On January 9, 2009, the Corporation issued and sold to the Treasury 28,685 shares of the Corporation Fixed Rate Cumulative Perpetual Preferred Stock, with a liquidation preference of \$1 thousand per share, and a ten-year warrant to purchase up to 150,296 shares of the Corporation's common stock at an exercise price of \$28.63 per share. Under the terms of the TARP program, the Treasury's consent will be required for any increase in our dividends paid to common stockholders (above a quarterly dividend of \$0.16 per common share) or the Corporation's redemption, purchase or acquisition of its common stock until the third anniversary of the Corporation's senior preferred share issuance to the Treasury unless prior to such third anniversary the senior preferred shares are redeemed in whole or the Treasury has transferred all of these shares to third parties.

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In January 2010, the Corporation redeemed 25 percent of the original senior preferred stock issued under the Treasury's CPP, repaying approximately \$7.2 million to the Treasury, including accrued and unpaid dividends. In March 2011, the Corporation redeemed an additional 25 percent of the senior preferred stock for approximately \$7.2 million. An aggregate of \$14.3 million in senior preferred stock remains outstanding and owned by the Treasury.

Participants in the TARP Capital Purchase Program were required to accept several compensation-related limitations associated with this Program. Each of our senior executive officers in January 2009 agreed in writing to accept the compensation standards in existence at that time under the program and thereby cap or eliminate some of their contractual or legal rights. The provisions agreed to were as follows:

- No golden parachute payments. "Golden parachute payment" under the TARP Capital Purchase Program means a severance payment resulting from involuntary termination of employment, or from bankruptcy of the employer, that exceeds three times the terminated employee's average annual base salary over the five years prior to termination. Our senior executive officers have agreed to forego all golden parachute payments for as long as two conditions remain true: They remain "senior executive officers" (CEO, Chief Financial Officer and the next three highest-paid executive officers), and the Treasury continues to hold our equity or debt securities we issued to it under the TARP Capital Purchase Program (the period during which the Treasury holds those securities is the "TARP Capital Purchase Program Covered Period.").
- Recovery of EIP Awards and Incentive Compensation if Based on Certain Material Inaccuracies. Our senior executive officers have also agreed to a "clawback provision," which means that we can recover incentive compensation paid during the TARP Capital Purchase Program Covered Period that is later found to have been based on materially inaccurate financial statements or other materially inaccurate measurements of performance.
- No Compensation Arrangements That Encourage Excessive Risks. During the TARP Capital Purchase Program Covered Period, we are not allowed to enter into compensation arrangements that encourage senior executive officers to take "unnecessary and excessive risks that threaten the value" of our company. To make sure this does not happen, the Corporation's Compensation Committee is required to meet at least once a year with our senior risk officers to review our executive compensation arrangements in the light of our risk management policies and practices. Our senior executive officers' written agreements include their obligation to execute whatever documents we may require in order to make any changes in compensation arrangements resulting from the Compensation Committee's review.
- Limit on Federal Income Tax Deductions. During the TARP Capital Purchase Program Covered Period, we are not allowed to take federal income tax deductions for compensation paid to senior executive officers in excess of \$500,000 per year, with certain exceptions that do not apply to our senior executive officers. This represents a 50% reduction in the income tax deductibility limit and the elimination of the exemption for performance-based compensation.

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (the "Stimulus Act") into law. The Stimulus Act modified the compensation-related limitations contained in the TARP Capital Purchase Program, created additional compensation-related limitations and directed the Secretary of the Treasury to establish standards for executive compensation applicable to participants in TARP, regardless of when participation commenced. Thus, the newly enacted compensation-related limitations are applicable to the Corporation and to the extent the Treasury may implement these restrictions unilaterally the Corporation will apply these provisions. The provisions may be retroactive. In their January 2009 agreements our executives did not waive their contract or legal rights with respect to these new and retroactive provisions; other officers now covered by these provisions were not asked and did not agree to waive their contract or legal rights. The compensation-related limitations applicable to the Corporation which have been added or modified by the Stimulus Act are as follows, which provisions must be included in standards established by the Treasury:

No severance payments. Under the Stimulus Act “golden parachutes” were redefined as any severance payment resulting from involuntary termination of employment, or from bankruptcy of the employer, except for payments for services performed or benefits accrued. Consequently under the Stimulus Act the Corporation is prohibited from making any severance payment to our “senior executive officers” (defined in the Stimulus Act as the five highest paid senior executive officers) and our next 5 most highly compensated employees during the TARP Capital Purchase Program Covered Period.