

INDEPENDENT BANK CORP /MI/

Form 10-Q

August 06, 2010

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2010

Commission file number 0-7818

INDEPENDENT BANK CORPORATION

(Exact name of registrant as specified in its charter)

Michigan

38-2032782

(State or jurisdiction of
Incorporation or Organization)

(I.R.S. Employer Identification
Number)

230 West Main Street, P.O. Box 491, Ionia, Michigan 48846

(Address of principal executive offices)

(616) 527-5820

(Registrant's telephone number, including area code)

NONE

Former name, address and fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 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 X 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 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 X
(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 Exchange Act).

YES _____ NO X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, no par value

75,123,427

Class

Outstanding at August 6, 2010

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
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Discussions and statements in this report that are not statements of historical fact, including, without limitation, statements that include terms such as will, may, should, believe, expect, forecast, anticipate, estimate, project, intend, likely, optimistic and plan, and statements about future or projected financial and operating results, plans, projections, objectives, expectations, and intentions and other statements that are not historical facts, are forward-looking statements. Forward-looking statements include, but are not limited to, descriptions of plans and objectives for future operations, products or services; projections of our future revenue, earnings or other measures of economic performance; forecasts of credit losses and other asset quality trends; predictions as to our bank's ability to maintain certain regulatory capital standards; our expectation that we will have sufficient cash on hand to meet expected obligations during 2010; and our expectations regarding a decrease in payment plan receivables held by Mepco and the resulting effect on our net interest margin. These forward-looking statements express our current expectations, forecasts of future events, or long-term goals and, by their nature, are subject to assumptions, risks, and uncertainties. Although we believe that the expectations, forecasts, and goals reflected in these forward-looking statements are reasonable, actual results could differ materially for a variety of reasons, including, among others:

- our ability to successfully raise new equity capital through a public offering of our common stock, effect a conversion of our outstanding preferred stock held by the U.S. Treasury into our common stock, and otherwise implement our capital restoration plan;*
- the failure of assumptions underlying the establishment of and provisions made to our allowance for loan losses;*
- the timing and pace of an economic recovery in Michigan and the United States in general, including regional and local real estate markets;*
- the ability of our bank to remain well-capitalized;*

the failure of assumptions underlying our estimate of probable incurred losses from vehicle service contract payment plan counterparty contingencies, including our assumptions regarding future cancellations of vehicle service contracts, the value to us of collateral that may be available to recover funds due from our counterparties, and our ability to enforce the contractual obligations of our counterparties to pay amounts owing to us;

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further adverse developments in the vehicle service contract industry, whose current turmoil has increased the credit risk and reputation risk for our subsidiary, Mepco;
potential limitations on our ability to access and rely on wholesale funding sources;
the continued services of our management team, particularly as we work through our asset quality issues and the implementation of our capital restoration plan;
implementation of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act or other new legislation, which may have significant effects on us and the financial services industry, the exact nature and extent of which cannot be determined at this time; and
the risk that our common stock may be delisted from the Nasdaq Global Select Market.

This list provides examples of factors that could affect the results described by forward-looking statements contained in this report, but the list is not intended to be all inclusive. The risk factors disclosed in Part I Item A of our Annual Report on Form 10-K for the year ended December 31, 2009, as updated by any new or modified risk factors disclosed in Part II Item 1A of any subsequently filed Quarterly Report on Form 10-Q, include all known risks our management believes could materially affect the results described by forward-looking statements in this report. However, those risks may not be the only risks we face. Our results of operations, cash flows, financial position, and prospects could also be materially and adversely affected by additional factors that are not presently known to us, that we currently consider to be immaterial, or that develop after the date of this report. We cannot assure you that our future results will meet expectations. While we believe the forward-looking statements in this report are reasonable, you should not place undue reliance on any forward-looking statement. In addition, these statements speak only as of the date made. We do not undertake, and expressly disclaim, any obligation to update or alter any statements, whether as a result of new information, future events, or otherwise, except as required by applicable law.

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Part I - Item 1.

INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Financial Condition

	June 30, 2010	December 31, 2009
	(unaudited)	
	(in thousands, except share amounts)	
Assets		
Cash and due from banks	\$ 52,663	\$ 65,214
Interest bearing deposits	303,268	223,522
	Cash and Cash Equivalents	288,736
Trading securities	27	54
Securities available for sale	112,947	164,151
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	26,443	27,854
Loans held for sale, carried at fair value	32,786	34,234
Loans		
Commercial	767,285	840,367
Mortgage	704,604	749,298
Installment	275,335	303,366
Payment plan receivables	285,749	406,341
	Total Loans	2,299,372
Allowance for loan losses	(75,606)	(81,717)
	Net Loans	2,217,655
Other real estate and repossessed assets	41,785	31,534
Property and equipment, net	70,277	72,616
Bank-owned life insurance	46,953	46,514
Other intangibles	9,615	10,260
Capitalized mortgage loan servicing rights	13,022	15,273
Prepaid FDIC deposit insurance assessment	18,811	22,047
Vehicle service contract counterparty receivables, net	25,376	5,419
Accrued income and other assets	25,821	29,017
	Total Assets	\$ 2,965,364
Liabilities and Shareholders' Equity		
Deposits		
Non-interest bearing	\$ 347,844	\$ 334,608
Savings and NOW	1,069,062	1,059,840
Retail time	537,496	542,170
Brokered time	422,749	629,150
	Total Deposits	2,565,768
Other borrowings	133,402	131,182
Subordinated debentures	50,175	92,888
Vehicle service contract counterparty payables	13,999	21,309

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Accrued expenses and other liabilities	32,762	44,356
Total Liabilities	2,607,489	2,855,503
Shareholders' Equity		
Preferred stock, no par value, 200,000 shares authorized		
Issued and outstanding:		
At June 30, 2010: Series B, 74,426 shares, \$1,010 liquidation preference per share	70,458	--
At December 31, 2009: Series A, 72,000 shares, \$1,000 liquidation preference per share	--	69,157
Common stock, no par value at June 30, 2010, and \$1.00 par value at December 31, 2009 authorized: 500,000,000 shares at June 30, 2010, and 60,000,000 shares at December 31, 2009; issued and outstanding: 75,123,427 shares at June 30, 2010, and 24,028,505 shares at December 31, 2009	250,737	23,863
Capital surplus	--	201,618
Accumulated deficit	(177,242)	(169,098)
Accumulated other comprehensive loss	(14,281)	(15,679)
Total Shareholders' Equity	129,672	109,861
Total Liabilities and Shareholders' Equity	\$ 2,737,161	\$ 2,965,364

See notes to interim condensed consolidated financial statements (unaudited)

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Operations

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2010	2009	2010	2009
	(unaudited)			
	(in thousands, except per share data)			
Interest Income				
Interest and fees on loans	\$ 36,675	\$ 45,224	\$ 75,702	\$ 89,625
Interest on securities				
Taxable	902	1,705	2,062	3,438
Tax-exempt	526	976	1,211	2,083
Other investments	389	239	761	563
Total Interest Income	38,492	48,144	79,736	95,709
Interest Expense				
Deposits	7,508	8,811	15,727	17,359
Other borrowings	2,413	3,814	5,407	8,484
Total Interest Expense	9,921	12,625	21,134	25,843
Net Interest Income	28,571	35,519	58,602	69,866
Provision for loan losses	12,680	25,659	29,694	55,783
Net Interest Income After Provision for Loan Losses	15,891	9,860	28,908	14,083
Non-interest Income				
Service charges on deposit accounts	5,833	6,321	11,108	11,828
Net gains (losses) on assets				
Mortgage loans	2,372	3,262	4,215	6,543
Securities	1,363	4,230	1,628	3,666
Other than temporary loss on securities available for sale				
Total impairment loss	--	--	(118)	(17)
Loss recognized in other comprehensive loss	--	--	--	--
Net impairment loss recognized in earnings	--	--	(118)	(17)
VISA check card interchange income	1,655	1,500	3,227	2,915
Mortgage loan servicing	(2,043)	2,349	(1,611)	1,507
Title insurance fees	366	732	860	1,341
Gain on extinguishment of debt	18,086	--	18,086	--
Other income	1,682	2,617	3,936	4,806
Total Non-interest Income	29,314	21,011	41,331	32,589
Non-interest Expense				
Compensation and employee benefits	13,430	13,328	26,643	25,905
Vehicle service contract counterparty contingencies	4,861	2,215	8,279	3,015

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Loan and collection	2,785	3,227	7,571	7,265
Occupancy, net	2,595	2,560	5,504	5,608
Data processing	2,039	2,010	4,144	4,106
Loss on other real estate and repossessed assets	1,554	1,939	3,583	3,200
FDIC deposit insurance	1,763	2,755	3,565	3,941
Furniture, fixtures and equipment	1,648	1,848	3,367	3,697
Credit card and bank service fees	1,500	1,668	3,175	3,132
Advertising	674	1,421	1,453	2,863
Other expenses	4,316	4,020	9,016	8,364
Total Non-interest Expense	37,165	36,991	76,300	71,096
Income (Loss) Before Income Tax	8,040	(6,120)	(6,061)	(24,424)
Income tax expense (benefit)	156	(959)	(108)	(666)
Net Income (Loss) \$	7,884 \$	(5,161) \$	(5,953) \$	(23,758)
Preferred dividends and discount accretion	1,113	1,075	2,190	2,150
Net Income (Loss) Applicable to Common Stock \$	6,771 \$	(6,236) \$	(8,143) \$	(25,908)
Net Income (Loss) Per Common Share				
Basic	\$.24	\$ (.26)	\$ (.31)	\$ (1.09)
Diluted	.04	(.26)	(.31)	(1.09)
Dividends Per Common Share				
Declared	\$.00	\$.01	\$.00	\$.02
Paid	.00	.01	.00	.02
See notes to interim condensed consolidated financial statements (unaudited)				

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows

	Six months ended June 30,	
	2010	2009
	(unaudited)	
	(in thousands)	
Net Loss	\$ (5,953)	\$ (23,758)
Adjustments to Reconcile Net Loss to Net Cash from (used in) Operating Activities		
Proceeds from the sales of trading securities	--	2,827
Proceeds from sales of loans held for sale	178,593	307,637
Disbursements for loans held for sale	(172,930)	(339,927)
Provision for loan losses	29,694	55,783
Depreciation, amortization of intangible assets and premiums and accretion of discounts on securities and loans	(16,925)	(19,752)
Net gains on sales of mortgage loans	(4,215)	(6,543)
Net gains on securities	(1,628)	(3,666)
Securities impairment recognized in earnings	118	17
Net loss on other real estate and repossessed assets	3,583	3,200
Vehicle service contract counterparty contingencies	8,279	3,015
Gain on extinguishment of debt	(18,086)	--
Deferred loan fees	326	(262)
Share based compensation	292	345
(Increase) decrease in accrued income and other assets	4,542	(1,178)
Increase (decrease) in accrued expenses and other liabilities	2,690	13,151
	14,333	14,647
Net Cash from (used in) Operating Activities	8,380	(9,111)
Cash Flow from Investing Activities		
Proceeds from the sale of securities available for sale	94,685	24,336
Proceeds from the maturity of securities available for sale	2,165	3,256
Principal payments received on securities available for sale	10,834	14,261
Purchases of securities available for sale	(53,355)	(14,256)
Redemption of Federal Reserve Bank stock	1,411	209
Portfolio loans originated, net of principal payments	190,798	(23,764)
Proceeds from the sale of other real estate	8,986	4,130
Capital expenditures	(2,017)	(4,758)
Net Cash from Investing Activities	253,507	3,414
Cash Flow from (used in) Financing Activities		
Net increase (decrease) in total deposits	(188,617)	302,445
Net decrease in other borrowings and federal funds purchased	(1,674)	(181,880)
Proceeds from Federal Home Loan Bank advances	33,000	241,524
Payments of Federal Home Loan Bank advances	(29,106)	(345,122)

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Net increase (decrease) in vehicle service contract counterparty payables	(7,310)	12,379
Extinguishment of debt, net	(985)	--
Dividends paid	--	(2,002)
Net Cash from (used in) Financing Activities	(194,692)	27,344
Net Increase in Cash and Cash Equivalents	67,195	21,647
Cash and Cash Equivalents at Beginning of Period	288,736	57,705
Cash and Cash Equivalents at End of Period	\$ 355,931	\$ 79,352
Cash paid during the period for		
Interest	\$ 21,873	\$ 25,912
Income taxes	204	150
Transfer of loans to other real estate	22,820	17,092
Transfer of payment plan receivables to vehicle service contract counterparty receivables	38,599	1,288
Common stock issued for extinguishment of debt	23,502	--
See notes to interim condensed consolidated financial statements (unaudited)		

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INDEPENDENT BANK CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Shareholders' Equity

	Six months ended June 30,	
	2010	2009
	(unaudited)	
	(in thousands)	
Balance at beginning of period	\$ 109,861	\$ 194,877
Net loss	(5,953)	(23,758)
Preferred dividends	(1,076)	(1,800)
Cash dividends declared	--	(481)
Issuance of common stock	23,502	1,193
Share based compensation	292	345
Issuance of Series B preferred stock	69,550	--
Retirement of Series A preferred stock	(69,364)	--
Issuance of common stock warrants	5,041	--
Retirement of common stock warrants	(3,579)	--
Net change in accumulated other comprehensive income, net of related tax effect	1,398	4,860
 Balance at end of period	 \$ 129,672	 \$ 175,236

See notes to interim condensed consolidated financial statements (unaudited)

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NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. The interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures made are adequate to make the information not misleading. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2009 included in our annual report on Form 10-K.

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all the adjustments necessary to present fairly our consolidated financial condition as of June 30, 2010 and December 31, 2009, and the results of operations for the three and six-month periods ended June 30, 2010 and 2009. The results of operations for the three and six-month periods ended June 30, 2010, are not necessarily indicative of the results to be expected for the full year. Certain reclassifications have been made in the prior period financial statements to conform to the current period presentation. Our critical accounting policies include the assessment for other than temporary impairment (OTTI) on investment securities, the determination of the allowance for loan losses, the determination of vehicle service contract payment plan counterparty contingencies, the valuation of derivative financial instruments, the valuation of originated mortgage loan servicing rights and the valuation of deferred tax assets. Refer to our 2009 Annual Report on Form 10-K for a disclosure of our accounting policies.

2. In June 2009, the FASB issued FASB ASC Topic 860 Transfers and Servicing (formerly SFAS No. 166 Accounting for Transfers of Financial Assets an Amendment of FASB Statement No. 140). This standard removes the concept of a qualifying special-purpose entity and limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire financial asset to an entity that is not consolidated with the transferor in the financial statements being presented and/or when the transferor has continuing involvement with the transferred financial asset. The adoption of this standard on January 1, 2010 did not have a material impact on our consolidated financial statements.

In June 2009, the FASB issued FASB ASC Topic 810-10, Consolidation (formerly SFAS No. 167 Amendments to FASB Interpretation No. 46(R)). The standard amends tests for variable interest entities to determine whether a variable interest entity must be consolidated. This standard requires an entity to perform an analysis to determine whether an entity s variable interest or interests give it a controlling financial interest in a variable interest entity. This standard requires ongoing reassessments of whether an entity is the primary beneficiary of a variable interest entity and enhanced disclosures that provide more transparent information about an entity s involvement with a variable interest entity. The adoption of this standard on January 1, 2010 did not have a material impact on our consolidated financial statements.

Table of Contents**NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
(unaudited)

3. Securities available for sale consist of the following:

	Amortized Cost	Unrealized		Fair Value
		Gains	Losses	
(in thousands)				
June 30, 2010				
U.S. Treasury	\$ 38,147	\$ 5	\$ -	\$ 38,152
U.S. agency residential mortgage-backed	14,066	278	-	14,344
Private label residential mortgage-backed	20,834	26	4,396	16,464
Obligations of states and political subdivisions	35,722	573	344	35,951
Trust preferred	9,466	-	1,430	8,036
Total	\$ 118,235	\$ 882	\$ 6,170	\$ 112,947
December 31, 2009				
U.S. agency residential mortgage-backed	\$ 46,108	\$ 1,500	\$ 86	\$ 47,522
Private label residential mortgage-backed	38,531	97	7,653	30,975
Other asset-backed	5,699	-	194	5,505
Obligations of states and political subdivisions	66,439	1,096	403	67,132
Trust preferred	14,272	456	1,711	13,017
Total	\$ 171,049	\$ 3,149	\$ 10,047	\$ 164,151

Our investments gross unrealized losses and fair values aggregated by investment type and length of time that individual securities have been at a continuous unrealized loss position follows:

	Less Than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in thousands)						
June 30, 2010						
Private label residential mortgage-backed	\$ -	\$ -	\$ 14,954	\$ 4,396	\$ 14,954	\$ 4,396
Obligations of states and political subdivisions	5,549	176	2,502	168	8,051	344
Trust preferred	4,551	230	3,485	1,200	8,036	1,430
Total	\$ 10,100	\$ 406	\$ 20,941	\$ 5,764	\$ 31,041	\$ 6,170
December 31, 2009						
U.S. agency residential mortgage-backed	\$ 7,310	\$ 86	\$ -	\$ -	\$ 7,310	\$ 86

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Private label residential mortgage-backed	4,343	112	18,126	7,541	22,469	7,653
Other asset backed	783	3	4,722	191	5,505	194
Obligations of states and political subdivisions	4,236	124	3,960	279	8,196	403
Trust preferred	-	-	7,715	1,711	7,715	1,711
Total	\$ 16,672	\$ 325	\$ 34,523	\$ 9,722	\$ 51,195	\$ 10,047

Table of Contents**NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
(unaudited)

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 the aforementioned 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. Private label residential mortgage and other asset-backed securities at June 30, 2010 we had 11 securities whose fair value is less than amortized cost. Eight of the issues are rated by a major rating agency as investment grade while three are below investment grade. During 2009 pricing conditions in the private label residential mortgage and other asset-backed security markets were characterized by sporadic secondary market flow, significant implied liquidity risk discounts, a wide bid / ask spread and an absence of new issuances of similar securities. In the first and second quarters of 2010, while this market is still closed to new issuance, secondary market trading activity increased and appeared to be more orderly than compared to 2009. In addition, many bonds are trading at levels near their economic value with fewer distressed valuations relative to 2009. Prices for many securities have been rising, due in part to negative new supply. This improvement in trading activity is supported by sales of 11 securities with an amortized cost of \$14.2 million at a \$0.2 million gain during the first quarter of 2010 and an additional seven securities (all of our remaining other asset-backed securities) with an amortized cost of \$5.3 million at a \$0.1 million gain during the second quarter of 2010.

The unrealized losses, while showing improvement in the aggregate during the first six months of 2010, are largely attributable to credit spread widening on these securities. The underlying loans within these securities include Jumbo (64%) and Alt A (36%).

	June 30, 2010		December 31, 2009	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(in thousands)			
Private label residential mortgage-backed				
Jumbo	\$ 10,589	\$ (2,098)	\$ 21,718	\$ (5,749)
Alt-A	5,875	(2,272)	9,257	(1,807)
Other asset-backed - Manufactured housing	-	-	5,505	(194)
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Table of Contents**NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**
(unaudited)

All of the private label residential mortgage-backed transactions have geographic concentrations in California, ranging from 29% to 59% of the collateral pool. Typical exposure levels to California (median exposure is 39%) are consistent with overall market collateral characteristics. Five transactions have modest exposure to Florida, ranging from 5% to 11%, and one transaction has modest exposure to Arizona (5%). The underlying collateral pools do not have meaningful exposure to Nevada, Michigan or Ohio. None of the issues involve subprime mortgage collateral. Thus the impact of this market segment is only indirect, in that it has impacted liquidity and pricing in general for private label residential mortgage-backed securities. The majority of transactions are backed by fully amortizing loans. However, eight transactions have concentrations in interest only loans ranging from 31% to 94%. The structure of the residential mortgage securities portfolio provides protection to credit losses. The portfolio primarily consists of senior securities as demonstrated by the following: super senior (8%), senior (57%), senior support (20%) and mezzanine (15%). The mezzanine classes are from seasoned transactions (71 to 101 months) with significant levels of subordination (8% to 25%). Except for the additional discussion below relating to other than temporary impairment, each private label residential mortgage security has sufficient credit enhancement via subordination to reasonably assure full realization of book value. This assertion is based on a transaction level review of the portfolio. Individual security reviews include: external credit ratings, forecasted weighted average life, recent prepayment speeds, underwriting characteristics of the underlying collateral, the structure of the securitization and the credit performance of the underlying collateral. The review of underwriting characteristics considers: average loan size, type of loan (fixed or ARM), vintage, rate, FICO, loan-to-value, scheduled amortization, occupancy, purpose, geographic mix and loan documentation. The review of the securitization structure focuses on the priority of cash flows to the bond, the priority of the bond relative to the realization of credit losses and the level of subordination available to absorb credit losses. The review of credit performance includes: current period as well as cumulative realized losses; the level of severe payment problems, which includes other real estate (ORE), foreclosures, bankruptcy and 90 day delinquencies; and the level of less severe payment problems, which consists of 30 and 60 day delinquencies.

All of these securities are receiving some principal and interest payments. Most of these transactions are passthrough structures, receiving pro rata principal and interest payments from a dedicated collateral pool for loans that are performing. The nonreceipt of interest cash flows is not expected and thus not presently considered in our discounted cash flow methodology discussed below.

In addition to the review discussed above, certain securities, including the three securities with a rating below investment grade, were reviewed for OTTI utilizing a cash flow projection. The scope of review included securities that account for 90% of the \$4.4 million in gross unrealized losses. The cash flow analysis forecasted cash flow from the underlying loans in each transaction and then applied these cash flows to the bonds in the securitization. The cash flows from the underlying loans considered contractual payment terms (scheduled amortization), prepayments, defaults and severity of loss given default. The analysis used dynamic assumptions for prepayments, defaults and severity. Near term prepayment assumptions were based on recently observed prepayment rates. In some cases, recently observed prepayment rates are depressed due to a sharp decline in new jumbo loan issuance. This loan market is heavily dependent upon securitization for funding, and new securitization transactions have been minimal. Some transactions have experienced a decline in prepayment activity due to the lack of refinancing opportunities for nonconforming mortgages. In these cases, our projections anticipate that prepayment rates gradually revert to historical levels. For seasoned ARM transactions, normalized prepayment rates are estimated at 15% to 25% CPR. For fixed rate collateral (one transaction), the prepayment speed is projected to increase modestly given the spread differential between the collateral and the current market rate for conforming mortgages.

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Near term default assumptions were based on recent default observations as well as the volume of existing real-estate owned, pending foreclosures and severe delinquencies. Default levels generally are projected to remain elevated for a period of time sufficient to address the level of distressed loans in the transaction. Our projections expect defaults to then decline as the housing market and the economy stabilize, generally after 2 to 3 years. Current severity assumptions are based on recent observations. Loss severity is expected to decline gradually as the housing market and the economy stabilize. Except for one below investment grade security discussed in further detail below, our cash flow analysis forecasts complete recovery of our cost basis for each reviewed security.

At June 30, 2010 one below investment grade private label residential mortgage-backed security with a fair value of \$6.8 million and an unrealized loss of \$0.5 million (amortized cost of \$7.3 million) had unrealized losses that were considered other than temporary. The underlying loans in this transaction are 30 year fixed rate jumbos with an average origination date FICO of 748 and an average origination date loan-to-value ratio of 73%. The loans backing this transaction were originated in 2007 and is our only security backed by 2007 vintage loans. We believe that this vintage is a key differentiating factor between this security and the others in our portfolio that do not have unrealized losses that are considered OTTI. The bond is a senior security that is receiving principal and interest payments similar to principal reductions in the underlying collateral. The cash flow analysis described above calculated an OTTI of \$0.5 million at June 30, 2010, \$0.116 million of this amount was attributed to credit and was recognized in our consolidated statements of operations (zero, \$0.051 million and \$0.051 million during the three months ended June 30, 2010, March 31, 2010 and December 31, 2009, respectively) while the balance was attributed to other factors and reflected in other comprehensive income (loss) during those same periods.

As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no other declines discussed above are deemed to be other than temporary.

Obligations of states and political subdivisions at June 30, 2010 we had 26 municipal securities whose fair value is less than amortized cost. The unrealized losses are largely attributed to a widening of market spreads and continued illiquidity for certain issues. The majority of the securities are not rated by a major rating agency. Approximately 77% of the non rated securities originally had a AAA credit rating by virtue of bond insurance. However, the insurance provider no longer has an investment grade rating. The remaining non rated issues are small local issues that did not receive a credit rating due to the size of the transaction. The non rated securities have a periodic internal credit review according to established procedures. As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no declines are deemed to be other than temporary.

Trust preferred securities at June 30, 2010 we had five securities whose fair value is less than amortized cost. All of our trust preferred securities are single issue securities issued by a trust subsidiary of a bank holding company. The pricing of trust preferred securities over the past two years has suffered from significant credit spread widening fueled by uncertainty regarding potential losses of financial companies, the absence of a liquid functioning secondary market and potential supply concerns from financial companies issuing new debt to recapitalize themselves. During the first six months of 2010, although still showing signs of weakness, pricing for non-rated issues improved from the prior year end due to credit spread tightening. Despite this year to date improvement, pricing deteriorated during the second quarter of 2010 relative to the first quarter of 2010. Two of the five securities are rated by a major rating agency as investment

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grade, while one is split rated (this security is rated as investment grade by one major rating agency and below investment grade by another) and the other two are non-rated. The two non-rated issues are relatively small banks and neither of these issues were ever rated. The issuers on these trust preferred securities, which had a combined amortized cost of \$2.8 million and a combined fair value of \$2.1 million as of June 30, 2010, continue to make interest payments and have satisfactory credit metrics.

Our OTTI analysis for trust preferred securities is based on a security level financial analysis of the issuer. This review considers: external credit ratings, maturity date of the instrument, the scope of the bank's operations, relevant financial metrics and recent issuer specific news. The analysis of relevant financial metrics includes: capital adequacy, asset quality, earnings and liquidity. We use the same OTTI review methodology for both rated and non-rated issues. During the first quarter of 2010 we recorded OTTI on an unrated trust preferred security of \$0.067 million (we had recorded OTTI on this security of \$0.183 million in prior periods). Specifically, this issuer has deferred interest payments on all of its trust preferred securities and is operating under a written agreement with the regulatory agencies that specifically prohibits dividend payments. The issuer is a relatively small bank with operations centered in southeast Michigan. The issuer reported losses in 2008 and 2009 and now is insolvent. Additionally, the issuer has a high volume of nonperforming assets. This investment's amortized cost has been written down to zero, compared to a par value of \$0.25 million.

The following table breaks out our trust preferred securities in further detail as of June 30, 2010 and December 31, 2009:

	June 30, 2010		December 31, 2009	
	Fair Value	Net Unrealized Gain (Loss)	Fair Value	Net Unrealized Gain (Loss)
	(in thousands)			
Trust preferred securities				
Rated issues - no OTTI	\$ 5,981	\$ (680)	\$ 11,188	\$ (212)
Unrated issues - no OTTI	2,055	(750)	1,761	(1,044)
Unrated issues - with OTTI	-	-	68	1

As management does not intend to liquidate these securities and it is more likely than not that we will not be required to sell these securities prior to recovery of these unrealized losses, no other declines discussed above are deemed to be other than temporary.

The amortized cost and fair value of securities available for sale at June 30, 2010, by contractual maturity, follow. The actual maturity may differ from the contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

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	Amortized Cost (in thousands)	Fair Value
Maturing within one year	\$ 40,818	\$ 40,850
Maturing after one year but within five years	9,108	9,213
Maturing after five years but within ten years	11,429	11,669
Maturing after ten years	21,980	20,407
	83,335	82,139
U.S. agency residential mortgage-backed	14,066	14,344
Private label residential mortgage-backed	20,834	16,464
Total	\$ 118,235	\$ 112,947

Gains and losses realized on the sale of securities available for sale are determined using the specific identification method and are recognized on a trade-date basis. A summary of proceeds from the sale of securities available for sale and gains and losses for the six month periods ending June 30, follows:

	Proceeds	Realized Gains (in thousands)	Losses(1)
2010	\$ 94,685	\$ 1,876	\$ 221
2009	24,336	2,835	107

(1) Losses in 2010 and 2009 exclude \$0.118 million and \$0.017 million of other than temporary impairment, respectively.

During 2010 and 2009 our trading securities consisted of various preferred stocks. During the first six months of 2010 and 2009 we recognized gains (losses) on trading securities of \$(0.027) million and \$0.938 million, respectively, that are included in net gains (losses) on assets in the consolidated statements of operations. \$(0.027) million and \$0.025 million of these amounts, relate to gains (losses) recognized on trading securities still held at each respective period end.

4. Our assessment of the allowance for loan losses is based on an evaluation of the loan portfolio, recent loss experience, current economic conditions and other pertinent factors. Loans on non-accrual status and past due more than 90 days (Non-performing Loans) amounted to \$84.5 million at June 30, 2010, and \$109.9 million at December 31, 2009.

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Impaired loans are as follows:

	June 30, 2010	December 31, 2009
	(in thousands)	
Impaired loans with no allocated allowance		
TDR	\$ 19,692	\$ 9,059
Non - TDR	4,574	2,995
Impaired loans with an allocated allowance		
TDR - allowance based on collateral	30,445	3,552
TDR - allowance based on present value cash flow	81,770	74,287
Non - TDR - allowance based on collateral	39,724	68,032
Total impaired loans	\$ 176,205	\$ 157,925
Amount of allowance for loan losses allocated		
TDR - allowance based on collateral	\$ 8,048	\$ 761
TDR - allowance based on present value cash flow	10,800	7,828
Non - TDR - allowance based on collateral	11,251	21,004
Total amount of allowance for losses allocated	\$ 30,099	\$ 29,593

Our average investment in impaired loans was approximately \$167.7 million and \$92.9 million for the six-month periods ended June 30, 2010 and 2009, respectively. Cash receipts on impaired loans on non-accrual status are generally applied to the principal balance. Interest income recognized on impaired loans during the first six months of 2010 and 2009 was approximately \$2.8 million and \$0.5 million, respectively, the majority of which was received in cash.

The increase in impaired loans relative to the decrease in Non-performing Loans during the first six months of 2010 reflects a \$34.4 million increase from December 31, 2009 in troubled debt restructured (TDR) loans that remain performing at June 30, 2010. The increase in TDR loans is primarily attributed to the restructuring of repayment terms of residential mortgage and commercial loans. TDR loans not already included in Non-performing Loans totaled \$106.4 million and \$72.0 million at June 30, 2010 and December 31, 2009, respectively.

An analysis of the allowance for loan losses is as follows:

Allowance for loan lossesSix months ended
June 30,

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	2010		2009	
	Loans	Unfunded Commitments	Loans	Unfunded Commitments
		(dollars in thousands)		
Balance at beginning of period	\$81,717	\$1,858	\$57,900	\$2,144
Additions (deduction)				
Provision for loan losses	29,694		55,783	
Recoveries credited to allowance	1,839		1,494	
Loans charged against the allowance	(37,644)		(49,906)	
Additions (deductions) included in non-interest expense		336		(152)
Balance at end of period	\$75,606	\$2,194	\$65,271	\$1,992
Net loans charged against the allowance to average Portfolio Loans (annualized)		3.33%	3.98%	
		14		

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5. Comprehensive income (loss) for the three- and six-month periods ended June 30 follows:

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
	(in thousands)			
Net income (loss)	\$ 7,884	\$ (5,161)	\$ (5,953)	\$ (23,758)
Net change in unrealized gain (loss) on securities available for sale, net of related tax effect	(1,329)	3,170	(1,247)	4,001
Change in unrealized losses on securities available for sale for which a portion of other than temporary impairment has been recognized in earnings	627	--	2,294	--
Net change in unrealized loss on derivative instruments, net of related tax effect	(33)	757	73	859
Reclassification adjustment for accretion on settled derivative instruments	203	--	278	--
Comprehensive income (loss)	\$ 7,352	\$ (1,234)	\$ (4,555)	\$ (18,898)

The net change in unrealized loss on securities available for sale reflects net gains reclassified into earnings as follows:

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
	(in thousands)			
Net gain reclassified into earnings	\$ 1,385	\$ 2,509	\$ 1,537	\$ 2,711
Federal income tax expense as a result of the reclassification of these amounts from comprehensive income	--	--	--	--

6. Our reportable segments are based upon legal entities. We currently have two reportable segments: Independent Bank (IB or Bank) and Mepco Finance Corporation (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 Prime beginning on January 1, 2010 and priced principally based on Brokered CD rates prior to that time. 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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A summary of selected financial information for our reportable segments as of or for the three-month and six-month periods ended June 30, follows:

As of or for the three months ended June 30,

	IB	Mepco ⁽¹⁾	Other ⁽²⁾	Elimination ⁽³⁾	Total
	(in thousands)				
2010					
Total assets	\$2,404,858	\$332,926	\$184,781	\$ (185,404)	\$2,737,161
Interest income	28,470	10,022	--	--	38,492
Net interest income	22,139	7,719	(1,287)	--	28,571
Provision for loan losses	12,814	(134)	--	--	12,680
Income (loss) before income tax	(9,183)	740	16,506	(23)	8,040
Net income (loss)	(9,076)	477	16,506	(23)	7,884
2009					
Total assets	\$2,512,641	\$461,314	\$270,476	\$ (267,802)	\$2,976,629
Interest income	34,725	13,419	--	--	48,144
Net interest income	24,587	12,590	(1,658)	--	35,519
Provision for loan losses	25,512	147	--	--	25,659
Income (loss) before income tax	(12,334)	7,948	(1,711)	(23)	(6,120)
Net income (loss)	(8,422)	4,995	(1,998)	264	(5,161)

⁽¹⁾ Total assets include gross payment plan receivables of \$0.3 million and \$4.8 million at June 30, 2010 and 2009, respectively from customers domiciled in Canada. The amount at June 30, 2010 represents less than 1% of total payment plan receivables outstanding and we anticipate this balance to decline in future periods.

⁽²⁾ Includes amounts relating to our parent company and certain insignificant operations.

⁽³⁾ Includes parent company's investment in subsidiaries and cash balances maintained at subsidiary.

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As of or for the six months ended June 30,

	IB	Mepco ⁽¹⁾	Other ⁽²⁾	Elimination ⁽³⁾	Total
	(in thousands)				
2010					
Total assets	\$2,404,858	\$332,926	\$184,781	\$ (185,404)	\$2,737,161
Interest income	58,131	21,605	--	--	79,736
Net interest income	45,028	16,696	(3,122)	--	58,602
Provision for loan losses	29,931	(237)	--	--	29,694
Income (loss) before income tax	(21,904)	1,824	14,066	(47)	(6,061)
Net income (loss)	(21,118)	1,146	14,066	(47)	(5,953)
2009					
Total assets	\$2,512,641	\$461,314	\$270,476	\$ (267,802)	\$2,976,629
Interest income	71,007	24,702	--	--	95,709
Net interest income	50,215	23,018	(3,367)	--	69,866
Provision for loan losses	55,474	309	--	--	55,783
Income (loss) before income tax	(35,697)	15,044	(3,724)	(47)	(24,424)
Net income (loss)	(29,567)	9,580	(4,011)	240	(23,758)

⁽¹⁾ Total assets include gross payment plan receivables of \$0.3 million and \$4.8 million at June 30, 2010 and 2009, respectively from customers domiciled in Canada. The amount at June 30, 2010 represents less than 1% of total finance receivables outstanding and we anticipate this balance to decline further in future periods.

⁽²⁾ Includes amounts relating to our parent company and certain insignificant operations.

⁽³⁾ Includes parent company's investment in subsidiaries and cash balances maintained at subsidiary.

7. Basic income (loss) per share includes weighted average common shares outstanding during the period and participating share awards. Diluted income (loss) per share includes the dilutive effect of additional potential common shares to be issued upon the conversion of convertible preferred stock, exercise of common stock warrants, exercise of stock options and stock units for a deferred compensation plan for non-employee directors.

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A reconciliation of basic and diluted earnings per share for the three-month and six-month periods ended June 30 follows:

	Three months ended June 30, 2010		Six months ended June 30, 2009	
	2010	2009	2010	2009
	(in thousands, except per share amounts)			
Net income (loss) applicable to common stock	\$ 6,771	\$ (6,236)	\$ (8,143)	\$ (25,908)
Convertible preferred stock dividends	904	--	904	--
Net income (loss) applicable to common stock for calculation of diluted earnings per share ⁽¹⁾	\$ 7,675	\$ (6,236)	\$ (7,239)	\$ (25,908)
Weighted average shares outstanding	28,524	24,030	26,290	23,700
Effect of convertible preferred stock	147,000	--	73,906	--
Effect of common stock warrants	463	--	233	--
Effect of stock options	16	--	8	--
Stock units for deferred compensation plan for non-employee directors	70	72	71	68
Shares outstanding for calculation of diluted earnings per share ⁽¹⁾	176,073	24,102	100,508	23,768
Net income (loss) per common share				
Basic	\$.24	\$ (.26)	\$ (.31)	\$ (1.09)
Diluted ⁽¹⁾	.04	(.26)	(.31)	(1.09)

⁽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 and stock units for 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.

Weighted average stock options outstanding that were anti-dilutive totaled 0.5 million and 1.6 million for the three-months ended June 30, 2010 and 2009, respectively. During the six-month periods ended June 30, 2010 and 2009, weighted-average anti-dilutive stock options totaled 0.8 million and 1.6 million, respectively.

8. We are required to record derivatives on the balance sheet 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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Our derivative financial instruments according to the type of hedge in which they are designated follows:

	Notional Amount	June 30, 2010 Average Maturity (years)	Fair Value
	(dollars in thousands)		
Cash Flow Hedges			
Pay fixed interest-rate swap agreements	\$20,000	3.2	\$(1,586)
Interest-rate cap agreements	10,000	0.6	1
	\$30,000	2.3	\$(1,585)
No hedge designation			
Interest-rate cap agreements	\$ 25,000	0.5	\$ --
Rate-lock mortgage loan commitments	30,048	0.1	991
Mandatory commitments to sell mortgage loans	61,331	0.1	(655)
Total	\$116,379	0.2	\$336

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 and interest-rate cap agreements.

Through certain special purposes entities we issue trust preferred securities as part of our capital management strategy. Certain of these trust preferred securities are variable rate which exposes us to variability in cash flows. To mitigate our exposure to fluctuations in cash flows resulting from changes in interest rates we entered into a pay-fixed interest-rate swap agreement in September, 2007 on approximately \$20.0 million of these variable rate trust preferred securities. During the fourth quarter of 2009 we elected to defer payment of interest on this variable rate trust preferred security. As a result, this pay-fixed interest rate swap was transferred to a no hedge designation and the \$1.6 million unrealized loss which was included as a component of accumulated other comprehensive loss at the time of the transfer is being reclassified into earnings over the remaining life of this pay-fixed swap. During the second quarter of 2010 we terminated this pay-fixed swap and the unrealized loss will continue to be reclassified into earnings over the remaining original life of the pay-fixed swap.

Pay-fixed interest-rate swaps convert the variable-rate cash flows on debt obligations to fixed-rates. Under interest-rate cap agreements, we will receive cash if interest rates rise above a predetermined level. As a result, we effectively have variable-rate debt with an established maximum rate. We pay an upfront premium on interest rate caps which is recognized in earnings in the same period in which the hedged item affects earnings. Unrecognized premiums from interest rate caps aggregated to \$0.03 million and \$0.1 million at June 30, 2010 and December 31, 2009, respectively.

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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 balance sheet 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 \$0.7 million, of unrealized losses on Cash Flow Hedges at June 30, 2010 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 are immediately recognized as interest expense. The maximum term of any Cash Flow Hedge at June 30, 2010 is 4.5 years.

Certain financial derivative instruments are not designated as hedges. The fair value of these derivative financial instruments have been recorded on our balance sheet and are adjusted on an ongoing basis to reflect their then current fair value. The changes in the fair value of derivative financial instruments not designated as hedges, are recognized currently in earnings.

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 gains on the sale of mortgage loans. We obtain market prices on Mandatory Commitments and Rate Lock Commitments. Net gains on the sale of mortgage loans, as well as net income may be more volatile as a result of these derivative instruments, which are not designated as hedges.

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The following table illustrates 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			
	June 30, 2010		December 31, 2009		June 30, 2010		December 31, 2009	
	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	\$ 1,586	Other liabilities	\$ 2,328
Interest-rate cap agreements	Other assets	\$ 1		\$ -	Other liabilities	-	Other liabilities	1
Total		1		-		1,586		2,329
Derivatives not designated as hedging instruments								
Pay-fixed interest rate swap agreements					Other liabilities	-	Other liabilities	1,930
Rate-lock mortgage loan commitments	Other assets	991	Other assets	217				
Mandatory commitments to sell mortgage loans	Other assets	-	Other assets	715	Other liabilities	655		-
Total		991		932		655		1,930
Total derivatives		\$ 992		\$ 932		\$ 2,241		\$ 4,259

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The effect of derivative financial instruments on the Condensed Consolidated Statements of Operations follows:

	Gain		Three Month Periods Ended June 30, Location of Gain (Loss) Reclassified from Accumulated		Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)		Location of Gain (Loss) Recognized		Gain (Loss) Recognized in Income(1)	
	Recognized in Other Comprehensive Income (Effective Portion)	2010	2009	Other Comprehensive Income into Income (Effective Portion)	2010	2009	in Income (1)	2010	2009	
Cash Flow Hedges										
Pay-fixed interest rate swap agreements	\$ 1,040	\$ 1,820		Interest expense	\$ (802)	\$ (724)				
Interest-rate cap agreements	48	251		Interest expense	(24)	(126)	Interest expense	\$ 8	\$ 13	
Total	\$ 1,088	\$ 2,071			\$ (826)	\$ (850)		\$ 8	\$ 13	
No hedge designation										
Pay-fixed interest rate swap agreements							Interest expense	\$ 398	\$ (35)	
Interest-rate cap agreements							Interest expense	-	96	
Rate-lock mortgage loan commitments							Mortgage loan gains	479	(914)	
Mandatory commitments to sell mortgage loans							Mortgage loan gains	(763)	1,489	
Total								\$ 114	\$ 636	

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

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	Gain Recognized in Other Comprehensive Income (Effective Portion)		Six Month Periods Ended June 30, Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)	Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion)		Location of Gain (Loss) Recognized	Gain (Loss) Recognized in Income(1)	
	2010	2009	2010	2009	in Income (1)	2010	2009	
Cash Flow Hedges								
Pay-fixed interest rate swap agreements	\$ 1,971	\$ 2,249	Interest expense	\$ (1,501)	\$ (1,217)			
Interest-rate cap agreements	140	581	Interest expense	(70)	(292)	Interest expense	\$ 2	\$ (3)
Total	\$ 2,111	\$ 2,830		\$ (1,571)	\$ (1,509)		\$ 2	\$ (3)
No hedge designation								
Pay-fixed interest rate swap agreements						Interest expense	\$ 409	\$ (134)
Interest-rate cap agreements						Interest expense	-	6
Rate-lock mortgage loan commitments						Mortgage loan gains	774	(261)
Mandatory commitments to sell mortgage loans						Mortgage loan gains	(1,370)	1,535
Total							\$ (187)	\$ 1,146

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

9. Intangible assets, net of amortization, were comprised of the following at June 30, 2010 and December 31, 2009:

	June 30, 2010		December 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in thousands)			
Amortized intangible assets - Core deposit	\$ 31,326	\$ 21,711	\$ 31,326	\$ 21,066

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Amortization of intangibles has been estimated through 2015 and thereafter in the following table, and does not take into consideration any potential future acquisitions or branch purchases.

(in thousands)

Six months ended December 31, 2010	\$	635
Year ending December 31:		
2011		1,371
2012		1,088
2013		1,078
2014		801
2015 and thereafter		4,642
Total	\$	9,615

10. We maintain performance-based compensation plans that include a long-term incentive plan that permits the issuance of share based compensation, including stock options and non-vested share awards. This plan, which is shareholder approved, permits the grant of additional share based awards for up to 0.9 million shares of common stock as of June 30, 2010. Share based compensation awards 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 2010 we completed a stock option exchange program under which eligible employees were able to exchange certain stock options for a lesser amount of new stock options. Pursuant to this stock option exchange program, 0.5 million stock options were exchanged for 0.1 million new stock options. The new stock options granted have an exercise price equal to the market value on the date of grant, generally vest over a one year period and have the same expiration dates as the options exchanged which ranged from 1.2 years to 7.2 years. The new options had a value substantially equal to the value of the options exchanged.

We also granted, pursuant to our performance-based compensation plans, 0.3 million stock options to our officers on January 30, 2009. 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.

Total compensation cost recognized during the three and six months ended June 30, 2010 and 2009 for stock option and restricted stock grants was \$0.2 million for each of the three month periods and \$0.3 million for each of the six month periods, respectively. The corresponding tax benefit relating to this expense was zero for the three and six months ended June 30, 2010 and 2009, respectively.

At June 30, 2010, the total expected compensation cost related to non-vested stock option and restricted stock awards not yet recognized was \$1.3 million. The weighted-average period over which this amount will be recognized is 2.3 years.

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A summary of outstanding stock option grants and transactions follows:

	Six-months ended June 30, 2010			
		Average	Weighted- Average	Aggregated
	Number of	Exercise	Contractual	Intrinsic
	Shares	Price	Term	Value (in
			(years)	thousands)
Outstanding at January 1, 2010	1,098,550	\$13.19		
Granted	99,855	0.70		
Exercised	--	--		
Exchanged	(547,138)	20.86		
Expired	(88,942)	8.34		
Outstanding at June 30, 2010	562,325	\$4.28	5.67	\$0
Vested and expected to vest at June 30, 2010	555,372	\$4.31	5.65	\$0
Exercisable at June 30, 2010	262,489	\$7.68	3.94	\$0

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

	2010	
	Number	Weighted
	of	Average
	Shares	Grant Date
		Fair Value
Outstanding at January 1, 2010	262,381	\$9.27
Granted	--	--
Vested	--	--
Forfeited	--	--
Outstanding at June 30, 2010	262,381	\$9.27

A summary of the weighted-average assumptions used in the Black-Scholes option pricing model for grants of stock options during 2010 follows:

Expected dividend yield	0.33%
Risk-free interest rate	2.10
Expected life (in years)	4.60
Expected volatility	91.77%
Per share weighted-average fair value	\$ 0.50

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 the weighted average 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.

There were no stock option exercises during the six month periods ending June 30, 2010 and 2009, respectively.

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11. At both June 30, 2010 and December 31, 2009 we had approximately \$2.0 million of gross unrecognized tax benefits. If recognized, the entire amount of unrecognized tax benefits, net of \$0.5 million federal tax on state benefits, would affect our effective tax rate. We do not expect the total amount of unrecognized tax benefits to significantly increase or decrease during the balance of 2010.

As a result of being in a net operating loss carryforward position, we have established a deferred tax asset valuation allowance against the majority of our net deferred tax assets. Accordingly, we are not recognizing much income tax expense (benefit) related to any income (loss) before income tax. The income tax expense (benefit) was \$0.16 million and \$(0.96) million for the three month periods ending June 30, 2010 and 2009, respectively and \$(0.11) million and \$(0.67) million for the six month periods ending June 30, 2010 and 2009, respectively. The benefit recognized during the six month period in 2010 and the three- and six-month periods in 2009 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.

Generally, the calculation for income tax expense (benefit) does not consider the tax effects of changes in other comprehensive income or loss, which is a component of shareholders' equity on the balance sheet. However, an exception is provided in certain circumstances, such as when there is a pre-tax loss from continuing operations. In such case, pre-tax income from other categories (such as changes in OCI) is included in the calculation of the tax expense (benefit) for the current year. For the three month periods ending June 30, 2010 and 2009 this resulted in an income tax expense (benefit) of \$0.12 million and \$(1.56) million, respectively. For the six month periods ending June 30, 2010 and 2009 this resulted in an income tax expense (benefit) of \$(0.12) million and \$(1.56) million, respectively.

12. 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 that impose the following restrictions:

We will not pay dividends on our outstanding common stock or the outstanding preferred stock held by the U.S. Department of Treasury (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 Bank (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, our subsidiary bank, adopted resolutions 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 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 troubled debt restructurings;

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 condition and operations that we believe most require our focus at this time. It is very possible that if we had not adopted these resolutions, the FRB and the OFIR may have imposed similar requirements on us through a memorandum of understanding or similar undertaking. We are not currently subject to any such regulatory agreement or enforcement action. However, we believe that if we are unable to substantially comply with the resolutions set forth above and if our financial condition and performance do not otherwise materially improve, we may face additional regulatory scrutiny and restrictions in the form of a memorandum of understanding or similar undertaking imposed by the regulators.

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 June 30, 2010 and December 31, 2009 categorized our bank as well capitalized. Management is not aware of any conditions or events that would have changed the most recent FDIC categorization.

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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)					
June 30, 2010						
Total capital to risk-weighted assets						
Consolidated	\$ 205,922	10.65%	\$ 154,612	8.00%	NA	NA
Independent Bank	203,962	10.55	154,663	8.00	\$ 193,329	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	\$ 180,435	9.34%	\$ 77,306	4.00%	NA	NA
Independent Bank	179,134	9.27	77,332	4.00	\$ 115,997	6.00%
Tier 1 capital to average assets						
Consolidated	\$ 180,435	6.41%	\$ 112,613	4.00%	NA	NA
Independent Bank	179,134	6.37	112,556	4.00	\$ 140,695	5.00%
December 31, 2009						
Total capital to risk-weighted assets						
Consolidated	\$ 233,166	10.58%	\$ 176,333	8.00%	NA	NA
Independent Bank	228,128	10.36	176,173	8.00	\$ 220,216	10.00%
Tier 1 capital to risk-weighted assets						
Consolidated	\$ 156,702	7.11%	\$ 88,166	4.00%	NA	NA
Independent Bank	199,909	9.08	88,086	4.00	\$ 132,130	6.00%
Tier 1 capital to average assets						
Consolidated	\$ 156,702	5.27%	\$ 119,045	4.00%	NA	NA
Independent Bank	199,909	6.72	118,909	4.00	\$ 148,636	5.00%
NA - Not applicable						

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The components of our regulatory capital are as follows:

	Consolidated		Independent Bank	
	June 30, 2010	December 31, 2009	June 30, 2010	December 31, 2009
	(in thousands)		(in thousands)	
Total shareholders equity	\$ 129,672	\$ 109,861	\$ 177,580	\$ 196,416
Add (deduct)				
Qualifying trust preferred securities	48,001	41,880	-	-
Accumulated other comprehensive loss	14,281	15,679	13,071	14,208
Intangible assets	(9,615)	(10,260)	(9,613)	(10,257)
Disallowed capitalized mortgage loan servicing rights	(1,160)	(559)	(1,160)	(559)
Disallowed deferred tax assets	(794)	-	(794)	-
Other	50	101	50	101
Tier 1 capital	180,435	156,702	179,134	199,909
Qualifying trust preferred securities	667	48,220	-	-
Allowance for loan losses and allowance for unfunded commitments limited to 1.25% of total risk-weighted assets	24,820	28,244	24,828	28,219
Total risk-based capital	\$ 205,922	\$ 233,166	\$ 203,962	\$ 228,128

In January 2010, we adopted a Capital Restoration Plan (the "Capital Plan"), as required by the Board resolutions adopted in December 2009, and described above, and submitted such Capital Plan to the FRB and the OFIR.

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 of June 30, 2010, our Bank continued to meet the requirements to be considered "well-capitalized" under federal regulatory standards. However, 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 elevated level of non-performing assets and given certain other risks and uncertainties we face.

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Set forth below are the actual capital ratios of our subsidiary bank as of June 30, 2010, 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 at 6/30/10	Minimum Ratios Established by our Board	Ratios Required to be Well- Capitalized
Total capital to risk weighted assets	10.55%	11.0%	10.0%
Tier 1 capital to average assets	6.37	8.0	5.0

Our Capital Plan (as modified in mid-2010) sets forth an objective of achieving these minimum capital ratios as soon as practicable, but no later than September 30, 2010 and maintaining such capital ratios through at least the end of 2012.

13. 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.

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.

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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. At June 30, 2010, Level 1 securities included U.S. Treasury securities included in our available for sale portfolio and certain preferred stocks included in our trading portfolio for which there are quoted prices in active markets. A trust preferred security included in our available for sale portfolio and classified as Level 1 at December 31, 2009 was sold during the first quarter of 2010. 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, other asset-backed securities, municipal securities and trust preferred securities. Level 3 securities at December 31, 2009 consisted of certain private label residential mortgage-backed and other asset-backed securities whose fair values were estimated using an internal discounted cash flow analysis. At December 31, 2009, the underlying loans within these securities included Jumbo (60%), Alt A (25%) and manufactured housing (15%). Except for the discount rate, the inputs used in this analysis could generally be verified and did not involve judgment by management. The discount rate used (an unobservable input) was established using a multifactor matrix whose base rate was the yield on agency mortgage-backed securities. The analysis added a spread to this base rate based on several credit related factors, including vintage, product, payment priority, credit rating and non performing asset coverage ratio. The add-on for vintage ranged from zero for transactions backed by loans originated before 2003 to 0.525% for the 2007 vintage. Product adjustments to the discount rate were: 0.05% to 0.20% for jumbo, 0.35% to 2.575% for Alt-A, and 3.00% for manufactured housing. Adjustments for payment priority were -0.25% for super seniors, zero for seniors, 1.00% for senior supports and 3.00% for mezzanine securities. The add-on for credit rating ranged from zero for AAA securities to 5.00% for ratings below investment grade. The discount rate for subordination coverage of nonperforming loans ranged from zero for structures with a coverage ratio of more than 10 times to 10.00% if the coverage ratio declined to less than 0.5 times. The discount rate calculation had a minimum add on rate of 0.25%. These discount rate adjustments were reviewed for reasonableness and considered trends in mortgage market credit metrics by product and vintage. The discount rates calculated in this manner were intended to differentiate investments by risk characteristics. Using this approach, discount rates ranged from 4.11% to 16.64%, with a weighted average rate of 8.91% and a median rate of 7.99%. The assumptions used reflected what we believed market participants would use in pricing these assets. See discussion below regarding transfer of these securities from Level 3 to Level 2 pricing during the first quarter of 2010.

Capitalized mortgage loan servicing rights: The fair value of capitalized mortgage loan servicing rights is based on a valuation model 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.

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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). During the fourth quarter of 2009, we transferred a \$2.2 million commercial real-estate loan from the commercial loan portfolio to held for sale. The fair value of this loan was based on a bid from a buyer and, therefore, is classified as a recurring Level 1 at December 31, 2009. This loan was sold for the recorded amount in January, 2010.

Derivatives: The fair value of derivatives, 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).

Impaired loans with specific loss allocations: 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 June 30, 2010, 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.

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 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 (nonrecurring 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	Fair Value Measurements Using		
	Measure-	Quoted	Significant	Significant
	ments	Prices	Other	Un-
	(Level 1)	in Active	Observable	observable
	(Level 1)	Markets	Inputs	Inputs
	(Level 1)	for	(Level 2)	(Level 3)
	(in thousands)	Identical	(Level 2)	(Level 3)
	(in thousands)	Assets	(Level 2)	(Level 3)
June 30, 2010:				
Measured at Fair Value on a Recurring basis:				
Assets				
Trading securities	\$ 27	\$ 27	\$ -	\$ -
Securities available for sale				
U.S. Treasury	38,152	38,152	-	-
U.S. agency residential mortgage-backed	14,344	-	14,344	-
Private label residential mortgage-backed	16,464	-	16,464	-
Obligations of states and political subdivisions	35,951	-	35,951	-
Trust preferred	8,036	-	8,036	-
Loans held for sale	32,786	-	32,786	-
Derivatives (1)	992	-	992	-
Liabilities				
Derivatives (2)	2,241	-	2,241	-
Measured at Fair Value on a Non-recurring basis:				
Assets				
Capitalized mortgage loan servicing rights (3)	12,661	-	-	12,661
Impaired loans	50,870	-	-	50,870
Other real estate	8,848	-	-	8,848
December 31, 2009:				
Measured at Fair Value on a Recurring basis:				
Assets				
Trading securities	\$ 54	\$ 54	\$ -	\$ -
Securities available for sale				
U.S. agency residential mortgage-backed	47,522	-	47,522	-
Private label residential mortgage-backed	30,975	-	-	30,975
Other asset-backed	5,505	-	-	5,505
Obligations of states and political subdivisions	67,132	-	67,132	-
Trust preferred	13,017	612	12,405	-
Loans held for sale	34,234	2,200	32,034	-
Derivatives (1)	932	-	932	-

Liabilities				
Derivatives (2)	4,259	-	4,259	-
Measured at Fair Value on a Non-recurring basis:				
Assets				
Capitalized mortgage loan servicing rights (3)	9,599	-	-	9,599
Impaired loans	49,819	-	-	49,819
Other real estate	10,497	-	-	10,497
(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.				

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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 Six-Month
Periods Ended June 30 for items Measured at
Fair Value Pursuant to Election of the Fair Value Option

	2010		2009		
	Net Gains (Losses) on Assets		Net Gains (Losses) on Assets		
	Securities	Loans	Securities	Loans	
					Total Change in Fair Values Included in Current Period Earnings (in thousands)
Trading securities	\$ (27)		\$ 938		\$ 938
Loans held for sale		\$ 913		\$ (285)	(285)

For those items measured at fair value pursuant to election of the fair value option, interest income is recorded within the 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 declared.

The following represent impairment charges recognized during the six month period ended June 30, 2010 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 \$12.7 million which is net of a valuation allowance of \$4.6 million at June 30, 2010 and had a carrying amount of \$9.6 million which is net of a valuation allowance of \$2.3 million at December 31, 2009. A recovery (charge) of \$(2.5) million and \$(2.3) million was included in our results of operations for the three and six month periods ending June 30, 2010, respectively and \$3.0 million and \$2.3 million during the same periods in 2009.

Loans which are measured for impairment using the fair value of collateral for collateral dependent loans, had a carrying amount of \$70.2 million, with a valuation allowance of \$19.3 million at June 30, 2010 and had a carrying amount of \$71.6 million, with a valuation allowance of \$21.8 million at December 31, 2009. An additional provision for loan losses relating to impaired loans of \$4.7 million and \$18.3 million was included in our results of operations for the three and six month periods ending June 30, 2010, respectively and \$13.2 million and \$35.2 million during the same periods in 2009.

Other real estate, which is measured using the fair value of the property, had a carrying amount of \$8.8 million which is net of a valuation allowance of \$6.7 million at June 30, 2010 and a carrying amount of \$10.5 million which is net of a valuation allowance of \$6.5 million at December 31, 2009. An additional charge of \$1.4 million and \$3.4 million was included in our results of operations during the three and six month periods ended June 30, 2010, respectively and \$1.9 million and \$3.2 million during the same periods in 2009.

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

	Securities Available for Sale	
	2010	2009
	(in thousands)	
Beginning balance	\$ 36,480	\$ -
Total gains (losses) realized and unrealized:		
Included in results of operations	132	-
Included in other comprehensive income	1,713	517
Purchases, issuances, settlements, maturities and calls	(16,940)	(3,560)
Transfers in and/or out of Level 3	(21,385)	47,381
Ending balance	\$ -	\$ 44,338
Amount of total gains (losses) for the period included in earnings attributable to the change in unrealized gains (losses) relating to assets still held at June 30	\$ 0	\$ 0

During the first quarter of 2009, certain private label residential mortgage- and other asset-backed securities totaling \$47.4 million were transferred to a level 3 valuation technique. We believe that market dislocation for these securities began in the last four months of 2008, particularly after the collapse of Lehman Brothers in September 2008. Since the disruption was very recent and historically there exists seasonally poor liquidity conditions at year end, we decided that it was appropriate to retain Level 2 pricing in 2008 and continue to monitor and review market conditions as we moved into 2009. During the first quarter of 2009 market conditions did not improve, in fact we believe market conditions worsened due to continued declines in residential home prices, increased consumer credit delinquencies, high levels of foreclosures, continuing losses at many financial institutions, and further weakness in the U.S. and global economies. This resulted in the market for these securities being extremely dislocated, Level 2 pricing not being based on orderly transactions and such pricing possibly being described as based on distressed sales. As a result, we determined that it was appropriate to modify the discount rate in the valuation model described above which resulted in these securities being reclassified to Level 3 pricing in the first quarter of 2009.

During the first quarter of 2010, we transferred these private label residential mortgage- and other asset-backed securities, totaling \$21.4 million, to a Level 2 valuation technique. In the first quarter of 2010, while this market was still closed to new issuance, secondary market trading activity increased and appeared to be more orderly than compared to 2009. In addition, many bonds were trading at levels near their economic value with fewer distressed valuations relative to 2009. Prices for many securities had been rising, due in part to negative new supply. This improvement in trading activity was supported by sales of 11 securities with a par value of \$14.2 million at a \$0.2 million gain during the first quarter of 2010 (none of these securities were originally purchased at a discount). The Level 2 valuation technique has also been supported through bids received from dealers on certain private label securities that approximated Level 2 pricing.

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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 (in thousands)	Contractual Principal
Loans held for sale			
June 30, 2010	\$32,786	\$1,190	\$31,596
December 31, 2009	34,234	278	33,956

14. 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.

Financial instrument assets actively traded in a secondary market, such as securities, have been valued using quoted market prices while recorded book balances have been used for cash and due from banks, interest bearing deposits and accrued interest.

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

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.

Financial instrument liabilities with a stated maturity, such as certificates of deposit and 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.

Subordinated debentures have generally been valued based on a quoted market price of the specific or similar instruments.

Derivative financial instruments have principally been valued based on discounted value of contractual cash flows using a discount rate approximating current market rates.

Financial instrument liabilities without a stated maturity, such as demand deposits, savings, NOW and money market accounts, have a fair value equal to the amount payable on demand.

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The estimated fair values and recorded book balances follow:

	June 30, 2010		December 31, 2009	
	Recorded Book Balance	Estimated Fair Value	Recorded Book Balance	Estimated Fair Value
	(in thousands)			
Assets				
Cash and due from banks	\$ 52,700	\$ 52,700	\$ 65,200	\$ 65,200
Interest bearing deposits	303,300	303,300	223,500	223,500
Trading securities	30	30	50	50
Securities available for sale	112,900	112,900	164,200	164,200
Federal Home Loan Bank and Federal Reserve Bank Stock	26,400	NA	27,900	NA
Net loans and loans held for sale	1,990,200	1,899,200	2,251,900	2,178,000
Accrued interest receivable	7,700	7,700	8,900	8,900
Derivative financial instruments	1,000	1,000	900	900
Liabilities				
Deposits with no stated maturity	\$ 1,416,900	\$ 1,416,900	\$ 1,394,400	\$ 1,394,400
Deposits with stated maturity	960,200	973,300	1,171,300	1,183,200
Other borrowings	133,400	138,100	131,200	136,300
Subordinated debentures	50,200	31,000	92,900	46,500
Accrued interest payable	3,800	3,800	4,500	4,500
Derivative financial instruments	2,200	2,200	4,300	4,300

The fair values for commitments to extend credit and standby letters of credit are estimated to approximate their aggregate book balance, which is nominal.

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.

15. Mepco purchases payment plans from companies (which we refer to as Mepco's counterparties) that provide vehicle service contracts and similar products to consumers. The payment plans (which are classified as payment plan receivables in our consolidated statements of financial condition) permit a consumer to purchase a 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 does not have recourse against the consumer for nonpayment of a payment plan, and therefore does not evaluate the creditworthiness of the individual customer. When consumers stop making payments or exercise their right to voluntarily cancel the contract, the remaining unpaid balance of the payment plan is normally recouped by Mepco from the counterparties that sold the

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contract and provided the coverage. The refund obligations of these counterparties are not fully secured. We record losses or charges in vehicle service contract contingencies expense, included in non-interest expenses, for estimated defaults by these counterparties in their obligations to Mepco.

We recorded an expense of \$4.9 million and \$2.2 million in the second quarters of 2010 and 2009, respectively and \$8.3 million and \$3.0 million in the first six months of 2010 and 2009, respectively for vehicle service contract payment plan counterparty contingencies. These charges relate to Mepco's aforementioned business activities and are being classified in non-interest expense because they are associated with a default or potential default of a contractual obligation under Mepco's contracts with business counterparties as opposed to loss on the payment plan itself. Our estimate of probable incurred losses from vehicle service contract payment plan 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 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 materially different than the levels that we recorded in 2010 and 2009.

In particular, Mepco had purchased a significant amount of payment plans from a single counterparty that declared bankruptcy on March 1, 2010. Mepco is actively working to reduce its credit exposure to this counterparty. The amount of payment plans (payment plan receivables) purchased from this counterparty and outstanding at June 30, 2010 totaled approximately \$93.2 million (compared to \$206.1 million at December 31, 2009). In addition, as of June 30, 2010, this counterparty owes Mepco \$38.0 million for previously cancelled payment plans. The bankruptcy and wind down of operations by this counterparty is likely to lead to substantial potential losses as this entity will not be in a position to honor all of its obligations on payment plans that Mepco has purchased which are cancelled prior to payment in full. Mepco will seek to recover amounts owed by the counterparty from various co-obligors and guarantors, through the liquidation of certain collateral held by Mepco, and through claims against this counterparty's bankruptcy estate. In the second half of 2009, Mepco established a \$19.0 million reserve for losses related to this counterparty. During the first six months of 2010 this reserve was increased by \$1.5 million, to \$20.5 million as of June 30, 2010. We currently believe this reserve is adequate given a review of all relevant factors.

In addition, several of these vehicle service contract marketers, including the counterparty described above and other companies, from which Mepco has purchased payment plans, have been sued or are under investigation for alleged violations of telemarketing laws and other consumer protection laws. The actions have been brought primarily by state attorneys general and the Federal Trade Commission but there have also been class action and other private lawsuits filed. In some cases, the companies have been placed into receivership or have discontinued business. In addition, the allegations, particularly those relating to blatantly abusive telemarketing practices by a relatively small number of marketers, have resulted in a significant amount of negative publicity that has adversely affected and may in the future continue to adversely affect sales and customer cancellations of purchased products throughout the industry, which have already been negatively impacted by the economic recession. It is possible these events could also cause federal or state lawmakers to enact legislation to further regulate the industry.

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The above described events have had and may continue to have an adverse impact on Mepco in several ways. First, we face increased risk with respect to certain counterparties defaulting in their contractual obligations to Mepco which could result in additional charges for losses if these counterparties go out of business. Second, these events have negatively affected sales and customer cancellations in the industry, which has had and is expected to continue to have a negative impact on the profitability of Mepco's business. In addition, if any federal or state investigation is expanded to include finance companies such as Mepco, Mepco will face additional legal and other expenses in connection with any such investigation. An increased level of private actions in which Mepco is named as a defendant will also cause Mepco to incur additional legal expenses as well as potential liability. Finally, Mepco has incurred and will likely continue to incur additional legal and other expenses, in general, in dealing with these industry problems. Net payment plan receivables held by Mepco totaled \$285.7 million (or approximately 10.4% of total assets) and \$406.3 million (or approximately 13.7% of total assets) at June 30, 2010 and December 31, 2009, respectively. We expect that the amount of total payment plans (payment plan receivables) held by Mepco will continue to decline during the remainder of 2010, due to the loss of business from the above described counterparty as well as our desire to reduce finance receivables as a percentage of total assets. This decline in payment plan receivables is expected to adversely impact our net interest income and net interest margin.

16. On January 29, 2010, we held a special shareholders' meeting at which our shareholders approved an amendment to our Articles of Incorporation to increase the number of shares of common stock we are authorized to issue from 60 million to 500 million. They also approved the issuance of our common stock in exchange for certain of our trust preferred securities and in exchange for the shares of our preferred stock held by the UST.

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 the 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 3,461,538 shares of our common stock.

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 3,461,538 shares of our common stock at an exercise price of \$0.7234 per share (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 are 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, our authorized number of directors will be

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automatically increased by two and the holders of the Series B Preferred Stock, voting together with holders of any then outstanding voting parity stock, will have the right to elect those 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.

Under the terms of the Series B Preferred Stock, UST (and any subsequent holder of the Series B Preferred Stock) will have the right to convert the Series B Preferred Stock into our common stock at any time. In addition, we will 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.

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 \$0.7234, 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. At June 30, 2010, the Series B Preferred Stock and accrued and unpaid dividends were convertible into approximately 79.0 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 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 \$0.8 million at June 30, 2010 or \$10 per share.

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The maximum number of shares of our common stock that may be issued upon conversion of all Series B Preferred Stock and any accrued dividends on Series B Preferred Stock is 144.0 million, unless we receive shareholder approval to issue a greater number of shares.

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 are redeemed prior to the first dividend payment date falling on or after the second anniversary of the original issue date, the redemption price will be equal to the \$1,000 liquidation amount per share plus any accrued and unpaid dividends. If the Series B Preferred Stock are redeemed on or after such date, 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 the Company gives 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 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 April of 2010, we commenced an offer to exchange up to 180.2 million newly issued shares of our common stock for properly tendered and accepted trust preferred securities issued by IBC Capital Finance II, IBC Capital Finance III, IBC Capital Finance IV, and Midwest Guaranty Trust I (the Exchange Offer). The Exchange Offer expired at 11:59 p.m., Eastern time, on June 22, 2010. We accepted for exchange 1,657,255 shares (\$41.4 million aggregate liquidation amount) of the trust preferred securities issued by IBC Capital Finance II, which were validly tendered and not withdrawn as of the expiration date for the Exchange Offer. No shares of the trust preferred securities issued by IBC Capital Finance III, IBC Capital Finance IV, or Midwest Guaranty Trust I were tendered.

We issued 51,091,250 shares of common stock at a price of \$0.46 per share in exchange for the validly tendered trust preferred securities issued by IBC Capital Finance II (including \$2.4 million of accrued and unpaid interest) and recorded a gain of \$18.1 million which is included in our consolidated statements of operations as Gain on extinguishment of debt. This gain was net of expenses paid totaling approximately \$1.0 million for dealer-manager fees, legal fees, accounting fees and other related costs as well as the pro rata write off of previously capitalized issue costs of \$1.2 million.

On April 27, 2010, at our annual meeting of shareholders, our shareholders also approved an amendment to our Articles of Incorporation that will allow us to effect a 1-for-10 reverse stock split. Although approved by our shareholders, we have not yet undertaken this reverse stock split.

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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 consolidated financial statements contained elsewhere in this report as well as our 2009 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 slowing economy in Michigan since 2001. Further, over the past few years, Michigan's unemployment rate has been consistently above the national average. 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 has 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 in 2008 and 2009 that reduced our capital, we have taken steps or initiated actions designed to restore our capital levels, improve our operations and augment our liquidity as described in more detail below.

If we are not successful in restoring our capital levels, we believe it is likely our bank will not be able to remain well-capitalized through the remainder of 2010, as we work through our 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 a regulatory enforcement action, a 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, an inability to improve our capital position would make it very difficult for us to withstand continued losses that we may incur and that may be increased or made more likely as a result of continued 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 a new Consumer Financial Protection Bureau with power to promulgate and enforce consumer protection laws; the creation of a 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 Securities and Exchange Commission; a provision that would broaden the base for FDIC insurance assessments; a provision under which interchange fees for debit cards would be set by the Federal Reserve under a restrictive reasonable and proportional cost per transaction standard; a provision that would require 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

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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. We expect that the Dodd-Frank Act will have a significant impact on the banking industry, including our organization.

It is against this backdrop that we discuss our results of operations and financial condition for the second quarter and first six months of 2010 as compared to earlier periods.

Results of Operations

Summary. We recorded net income of \$7.9 million and net income applicable to common stock of \$6.8 million during the three months ended June 30, 2010 compared to a net loss of \$5.2 million and a net loss applicable to common stock of \$6.2 million during the comparable period in 2009. The improvement in 2010 is primarily due to a significant gain on the extinguishment of debt and a decrease in the provision for loan losses that were partially offset by decreases in net interest income and mortgage loan servicing income.

We incurred a net loss of \$6.0 million and \$23.8 million and a net loss applicable to common stock of \$8.1 million and \$25.9 million during the six months ended June 30, 2010 and 2009, respectively. 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 June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net income (loss) (annualized) to ⁽¹⁾				
Average assets	0.96%	(0.83)%	(0.57)%	(1.75)%
Average equity	111.56	(22.98)	(57.53)	(44.24)
Net income (loss) per common share ⁽¹⁾				
Basic	\$ 0.24	\$(0.26)	\$(0.31)	\$(1.09)
Diluted	0.04	(0.26)	(0.31)	(1.09)

⁽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.

Net interest income decreased by 19.6% to \$28.6 million and by 16.1% to \$58.6 million, respectively, during the three- and six-month periods in 2010 compared to 2009. These decreases

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reflect declines in our net interest income as a percent of average interest-earning assets (the net interest margin) as well as in our average interest-earning assets. The decline in the net interest margin primarily reflects a decrease in the yield on interest earning assets principally due to a change in the mix of interest-earning assets with a declining level of higher yielding loans and an increasing level of lower yielding short-term investments, as described in more detail below. The change in asset mix reflects our strategy to preserve our regulatory capital levels by reducing loan balances that have higher risk weightings for regulatory capital purposes.

Beginning in the last half of 2009 and continuing throughout the first half of 2010, we have maintained a high level of lower-yielding interest bearing cash balances to augment our liquidity in response to our deteriorating financial condition (see Liquidity and capital resources). In addition, due to the challenges facing our subsidiary, Mepco Finance Corporation (Mepco) (see Noninterest expense), we expect the balance of payment plan receivables to decline by approximately 40% in 2010 (such payment plan receivables declined by \$120.6 million, or 29.7%, during the first half of 2010, which represents a 59.4% annualized rate). 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 two items (an increase in the level of lower-yielding interest bearing cash balances and a decrease in the level of higher-yielding payment plan receivables) has had (in the second quarter and first six months of 2010) and is expected to continue to have an adverse impact on our 2010 net interest income and net interest margin.

The current interest rate environment (lower short-term interest rates and a steeper yield curve) has exacerbated the adverse impact of maintaining a high level of liquidity.

Our net interest income is also adversely impacted by our level of non-accrual loans. In the second quarter and first six months of 2010 non-accrual loans averaged \$91.6 million and \$97.5 million, respectively compared to \$121.5 million and \$124.5 million, respectively for the same periods in 2009. In addition, in the second quarter and first six months of 2010 we reversed \$0.2 million and \$0.5 million, respectively, of accrued and unpaid interest on loans placed on non-accrual during each period compared to \$0.8 million and \$1.7 million, respectively during the same periods in 2009.

Table of Contents**Average Balances and Rates**

	Average Balance	2010		Three Months Ended June 30, 2009		
		Interest	Rate	Average Balance	Interest	Rate
(dollars in thousands)						
Assets ⁽¹⁾						
Taxable loans	\$2,115,837	\$ 36,569	6.93%	\$2,513,367	\$ 45,157	7.20%
Tax-exempt loans ⁽²⁾	9,866	106	4.31	7,069	67	3.80
Taxable securities	87,554	902	4.13	118,116	1,705	5.79
Tax-exempt securities ⁽²⁾	49,012	526	4.30	88,601	976	4.42
Cash interest bearing	324,592	192	0.24			
Other investments	27,001	197	2.93	28,011	239	3.42
Interest Earning Assets	2,613,862	38,492	5.90	2,755,164	48,144	7.01
Cash and due from banks	48,751			74,659		
Other assets, net	160,291			165,715		
Total Assets	\$2,822,904			\$2,995,538		
Liabilities						
Savings and NOW	\$1,088,526	670	0.25	\$ 974,994	1,493	0.61
Time deposits	1,019,882	6,838	2.69	979,506	7,318	3.00
Other borrowings	227,979	2,413	4.25	448,714	3,814	3.41
Interest Bearing Liabilities	2,336,387	9,921	1.70	2,403,214	12,625	2.11
Demand deposits	340,558			320,920		
Other liabilities	52,051			93,861		
Shareholders equity	93,908			177,543		
Total liabilities and shareholders equity	\$2,822,904			\$2,995,538		
Net Interest Income		\$ 28,571			\$ 35,519	
Net Interest Income as a Percent of Earning Assets			4.38%			5.17%

(1) All domestic, except for \$0.4 million and \$8.8 million for the three months ended June 30, 2010 and 2009, 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.

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	Average Balance	2010		Six Months Ended June 30, 2009		Rate
		Interest	Rate	Average Balance	Interest	
(dollars in thousands)						
Assets ⁽¹⁾						
Taxable loans	\$2,184,046	\$ 75,491	6.95%	\$2,504,582	\$ 89,457	7.19%
Tax-exempt loans ⁽²⁾	9,997	211	4.26	8,490	168	3.99
Taxable securities	91,859	2,062	4.53	116,478	3,438	5.95
Tax-exempt securities ⁽²⁾	56,671	1,211	4.31	95,795	2,083	4.38
Cash interest bearing	299,910	349	0.23			
Other investments	27,426	412	3.03	28,641	563	3.96
Interest Earning Assets	2,669,909	79,736	6.01	2,753,986	95,709	6.99
Cash and due from banks	53,855			67,935		
Other assets, net	154,408			162,086		
Total Assets	\$2,878,172			\$2,984,007		
Liabilities						
Savings and NOW	\$1,086,524	1,533	0.28	\$ 960,032	3,074	0.65
Time deposits	1,073,452	14,194	2.67	917,609	14,285	3.14
Other borrowings	227,801	5,407	4.79	523,630	8,484	3.27
Interest Bearing Liabilities	2,387,777	21,134	1.78	2,401,271	25,843	2.17
Demand deposits	334,100			314,762		
Other liabilities	58,359			81,267		
Shareholders equity	97,936			186,707		
Total liabilities and shareholders equity	\$2,878,172			\$2,984,007		
Net Interest Income		\$ 58,602			\$ 69,866	
Net Interest Income as a Percent of Earning Assets			4.41%			5.10%

(1) All domestic, except for \$0.7 million and \$7.4 million for the six months ended June 30, 2010 and 2009, 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.

Provision for loan losses. The provision for loan losses was \$12.7 million and \$25.7 million during the three months ended June 30, 2010 and 2009, respectively. During the six-month periods ended June 30, 2010 and 2009, the provision was \$29.7 million and \$55.8 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 second quarter and first half of 2010 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

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losses and their impact on the provision for loan losses in the second quarter and first half of 2010.

Non-interest income. Non-interest income is a significant element in assessing our results of operations. On a long-term basis we are attempting to grow non-interest income in order to diversify our revenues within the financial services industry. We regard net gains on mortgage loan sales 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. As a result, we believe it is best to evaluate our success in growing non-interest income and diversifying our revenues by also comparing non-interest income when excluding net gains (losses) on assets (mortgage loans and securities).

Non-interest income totaled \$29.3 million during the three months ended June 30, 2010, an \$8.3 million increase from the comparable period in 2009. This increase was primarily due to a significant gain from the extinguishment of debt that was partially offset by decreases in service charges on deposit accounts, mortgage loan servicing income, title insurance fees and other non-interest income as well as a decline in gains on mortgage loans and securities. For the first six months of 2010 non-interest income totaled \$41.3 million, an \$8.7 million increase from the comparable period in 2009. The year to date changes are generally commensurate with the quarterly changes.

Non-Interest Income

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
	(in thousands)			
Service charges on deposit accounts	\$5,833	\$6,321	\$11,108	\$11,828
Net gains (losses) on assets:				
Mortgage loans	2,372	3,262	4,215	6,543
Securities	1,363	4,230	1,628	3,666
Other than temporary loss on securities available for sale:				
Total impairment loss	--	--	(118)	(17)
Recognized in other comprehensive loss	--	--	--	--
Net impairment loss in earnings	--	--	(118)	(17)
VISA check card interchange income	1,655	1,500	3,227	2,915
Mortgage loan servicing	(2,043)	2,349	(1,611)	1,507
Mutual fund and annuity commissions	409	539	798	992
Bank owned life insurance	483	355	951	756
Title insurance fees	366	732	860	1,341
Gain on extinguishment of debt	18,086	--	18,086	--
Other	790	1,723	2,187	3,058
Total non-interest income	\$29,314	\$21,011	\$41,331	\$32,589

Service charges on deposit accounts declined during the three- and six-month periods ended June 30, 2010, respectively, from the comparable periods in 2009. The decrease in such service charges principally relates to a decline in non-sufficient funds (NSF) occurrences and related NSF fees. We believe the decline in NSF occurrences is due to our customers managing their

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finances more closely in order to reduce NSF activity and avoid the associated fees because of the current challenging economic conditions. In late 2009, the Federal Reserve adopted rules that will require a written opt-in from customers before a bank can assess overdraft fees on ATM or debit card transactions. These rules are effective for new customers on July 1, 2010 and for existing customers on August 15, 2010. We believe that such legislation will have an adverse impact on our present level of service charges on deposits accounts. At the present time, based on projected customer opt-in levels, we are anticipating an approximate 10% decline in service charges on deposits on an annualized basis as a result of this legislation.

Net gains on the sale of mortgage loans decreased on both a quarterly and a year to date basis. The decrease in gains relates primarily to a decline in mortgage loan origination volume, loan sales and commitments to originate mortgage loans that are held for sale. The first half of 2009 reflected a significant amount of refinancing activity resulting from generally lower mortgage loan interest rates during that time period. Although mortgage loan interest rates were quite low during the second quarter of 2010, refinance activity has been moderate as many borrowers had already refinanced in 2009 (and the interest rate differential between where they refinanced in 2009 and current interest rates was not that significant). Also, many borrowers are unable to refinance because of negative equity in their homes or credit related impediments.

Mortgage Loan Activity

	Three months ended		Six months ended	
	June 30, 2010	2009	June 30, 2010	2009
	(dollars in thousands)			
Mortgage loans originated	\$93,900	\$196,927	\$183,907	\$351,535
Mortgage loans sold	87,583	158,173	175,291	300,809
Mortgage loans sold with servicing rights released	20,747	9,174	32,611	14,603
Net gains on the sale of mortgage loans	2,372	3,262	4,215	6,543
Net gains as a percent of mortgage loans sold (Loan Sale Margin)	2.71%	2.06%	2.40%	2.18%
Fair value adjustments included in the Loan Sale Margin	0.43	0.04	0.18	0.33

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 cannot profitably fund within 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.

Net securities gains totaled \$1.4 million during the three months ended June 30, 2010, compared to \$4.2 million for the comparable period in 2009. The second quarter 2010 net securities gains were primarily due to the sale of agency mortgage backed securities. The second quarter 2009 net securities gains were primarily due to increases in the fair value and gains on the sale of a Bank of America preferred stock. We sold all of this preferred stock in June 2009. The sale of securities generally reflects our process of selectively deleveraging the balance sheet over the past two years in order to preserve regulatory capital ratios and augment liquidity.

Net securities gains totaled \$1.5 million during the first half of 2010, compared to \$3.6 million for the comparable period in 2009. We generated net securities gains of \$0.1 million in the first

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quarter of 2010, due primarily to a \$0.3 million net gain on the sale of municipal, bank trust preferred and private-label residential mortgage-backed investment securities. The gains were offset by \$0.1 million of other than temporary impairment charges. We incurred securities losses of \$0.6 million in the first quarter of 2009 due to declines in the fair value of trading securities of \$0.8 million that were partially offset by \$0.2 million of securities gains due principally to the sale of municipal securities.

VISA check card interchange income increased on both a comparative quarterly and year-to-date basis in 2010 compared to 2009. These results are principally attributable to a rise in the frequency of use of our VISA check card product by our customers. As described earlier, the Dodd-Frank Wall Street Reform and Consumer Protection Act includes a provision under which interchange fees for debit cards would be set by the Federal Reserve under a restrictive reasonable and proportional cost per transaction standard. Debit card issuers with less than \$10 billion in assets are exempt from this provision. As a result, the impact on our future levels of VISA check card interchange income is not presently known.

Mortgage loan servicing generated a loss of \$2.0 million and \$1.6 million in the second quarter and first six months of 2010, respectively, compared to income of \$2.3 million and \$1.5 million in the corresponding periods of 2009, respectively. These variances are primarily due to changes in the impairment reserve on, and the amortization of, capitalized mortgage loan servicing rights. The period end impairment reserve is based on a valuation of our mortgage loan servicing portfolio and the amortization is primarily impacted by prepayment activity. The 2010 impairment charge primarily reflects lower mortgage loan interest rates resulting in higher estimated future prepayment rates being used in the valuation at June 30, 2010. Activity related to capitalized mortgage loan servicing rights is as follows:

Capitalized Real Estate Mortgage Loan Servicing Rights

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
	(in thousands)			
Balance at beginning of period	\$15,435	\$11,589	\$15,273	\$11,966
Originated servicing rights capitalized	680	1,624	1,455	3,123
Amortization	(633)	(1,640)	(1,391)	(2,819)
(Increase)/decrease in impairment reserve	(2,460)	2,965	(2,315)	2,268
Balance at end of period	\$13,022	\$14,538	\$13,022	\$14,538
Impairment reserve at end of period	\$4,617	\$2,383	\$4,617	\$2,383

At June 30, 2010 we were servicing approximately \$1.74 billion in mortgage loans for others on which servicing rights have been capitalized. This servicing portfolio had a weighted average coupon rate of approximately 5.64% and a weighted average service fee of 25.6 basis points. Remaining capitalized mortgage loan servicing rights at June 30, 2010 totaled \$13.0 million and had an estimated fair market value of \$13.2 million. Nearly all of our mortgage loans serviced for others at June 30, 2010 are for either Fannie Mae or Freddie Mac. Because of our current financial condition, 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

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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.

Mutual fund and annuity commissions decreased on both a comparative quarterly and year-to-date basis in 2010 compared to 2009 reflecting lower sales of these products. These lower sales are primarily due to customer uncertainty about the economy and concerns about the volatility of the equities market as well as the elimination of certain personnel within the wealth management portion of our investment and insurance sales force in early 2010.

Income from bank owned life insurance increased on both a comparative quarterly and year-to-date basis in 2010 compared to 2009 primarily reflecting a higher average crediting rate on our cash surrender value due to generally improved total returns on the underlying separate account assets.

Title insurance fees decreased on both a comparative quarterly and year-to-date basis in 2010 compared to 2009 primarily as a result of the aforementioned decline in mortgage lending origination volume.

In the second quarter of 2010, we recorded an \$18.1 million gain on the extinguishment of debt. On June 23, 2010, we exchanged 51.1 million shares of our common stock (having a fair value of approximately \$23.5 million on the date of the exchange) for \$41.4 million in liquidation amount of trust preferred securities and \$2.3 million of accrued and unpaid interest on such securities.

Other non-interest income decreased on both a comparative quarterly and year-to-date basis in 2010 compared to 2009. The declines in 2010 are due primarily to an increase in losses of \$0.6 million and \$0.5 million for the second quarter and first six months of 2010, respectively, incurred in our private mortgage reinsurance captive. The 2010 losses reflect increased mortgage loan defaults and lower real estate values which lead to higher private mortgage insurance claims. Other non-interest income in the second quarter and first six months of 2009 also included \$0.5 million related to foreign currency transaction gains associated with Canadian dollar denominated payment receivables. The Canadian dollar appreciated significantly compared to the US dollar in the second quarter of 2009. Total Canadian dollar denominated payment plan receivables had declined to \$0.3 million and \$1.7 million at June 30, 2010 and December 31, 2009, respectively. As a result, we would expect future foreign currency transaction gains or losses to be insignificant.

Non-interest expense. Non-interest expense is an important component of our results of operations. Historically, we primarily focused on revenue growth, and while we strive to efficiently manage our cost structure, our non-interest expenses generally increased from year to year because we expanded our operations through acquisitions and by opening new branches and loan production offices. Because of the current challenging economic environment that we are confronting, our expansion through acquisitions or by opening new branches is unlikely in the near term unless we are successful in raising new capital, as described below. Further, management is focused on a number of initiatives to reduce and contain non-interest expenses.

Non-interest expense increased by \$0.2 million to \$37.2 million and by \$5.2 million to \$76.3 million during the three- and six-month periods ended June 30, 2010, respectively, compared to the like periods in 2009. The comparative quarterly increase is primarily due to a rise in vehicle

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service counterparty contingencies expense and credit costs related to unfunded lending commitments that were largely offset by declines in loan and collection expenses, loss on other real estate (ORE) and repossessed assets, FDIC deposit insurance and advertising expenses. The year-to-date comparative increase was primarily due to a rise in compensation and employee benefits expense, vehicle service contract counterparty contingencies expense, loan and collection expenses, and loss on ORE and repossessed assets.

Non-Interest Expense

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
	(in thousands)			
Salaries	\$10,242	\$9,815	\$20,418	\$19,484
Performance-based compensation and benefits	655	747	1,299	1,076
Other benefits	2,533	2,766	4,926	5,345
Compensation and employee benefits	13,430	13,328	26,643	25,905
Vehicle service contract counterparty contingencies	4,861	2,215	8,279	3,015
Loan and collection	2,785	3,227	7,571	7,265
Occupancy, net	2,595	2,560	5,504	5,608
Data processing	2,039	2,010	4,144	4,106
Loss on other real estate and repossessed assets	1,554	1,939	3,583	3,200
FDIC deposit insurance	1,763	2,755	3,565	3,941
Furniture, fixtures and equipment	1,648	1,848	3,367	3,697
Credit card and bank service fees	1,500	1,668	3,175	3,132
Communications	1,015	1,107	2,088	2,152
Legal and professional	894	705	2,030	1,346
Advertising	674	1,421	1,453	2,863
Supplies	415	457	808	926
Amortization of intangible assets	323	474	645	975
Credit costs related to unfunded lending commitments	280	(66)	336	(152)
Other	1,389	1,343	3,109	3,117
Total non-interest expense	\$37,165	\$36,991	\$76,300	\$71,096

Compensation and employee benefits expenses increased by \$0.1 million to \$13.4 million and by \$0.7 million to \$26.6 million during the three- and six-month periods ended June 30, 2010, respectively, compared to 2009, primarily because the deferral (as direct loan origination costs) of such expenses has decreased in 2010 as a result of the decline in loan origination activity. The amount of compensation and employee benefits expenses that were deferred as direct loan origination costs declined by \$1.3 million and \$2.4 million in second quarter and first six month of 2010, respectively, compared to the like periods in 2009. For 2010, we froze salaries at 2009 levels, eliminated bonuses, eliminated our 401(k) match, and eliminated any employee stock ownership plan contribution. Further, the number of full time equivalent employees has declined slightly in 2010 compared to year ago levels.

We record estimated incurred losses associated with Mepco's vehicle service contract payment plans in our provision for loan losses and establish a related allowance for loan losses. (See

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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 consolidated statements of operations.

We recorded an expense of \$4.9 million and \$8.3 million for vehicle service contract payment plan counterparty contingencies in the second quarter and first six months of 2010, respectively, compared to \$2.2 million and \$3.0 million, respectively, for the comparable periods in 2009. Our estimate of probable incurred losses from vehicle service contract payment plan 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 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 materially different than the levels that we recorded in 2010 and 2009.

In particular, Mepco had purchased a significant amount of payment plans from a single counterparty that declared bankruptcy on March 1, 2010. Mepco is actively working to reduce its credit exposure to this counterparty. The amount of payment plan receivables purchased from this counterparty and outstanding at June 30, 2010 totaled approximately \$93.2 million (compared to \$206.1 million at December 31, 2009). In addition, as of June 30, 2010, this counterparty owed Mepco \$38.0 million for previously cancelled payment plans. The bankruptcy and wind down of operations by this counterparty is likely to lead to substantial potential losses as this entity will not be in a position to honor all of its obligations on payment plans that Mepco has purchased which are cancelled prior to payment in full. Mepco will seek to recover amounts owed by the counterparty from various co-obligors and guarantors, through the liquidation of certain collateral held by Mepco, and through claims against this counterparty's bankruptcy estate. In the second half of 2009, Mepco established a \$19.0 million reserve for losses related to this counterparty. During the first six months of 2010 this reserve was increased by \$1.5 million, to \$20.5 million as of June 30, 2010. We currently believe this reserve is adequate given a review of all relevant factors.

The aggregate amount of obligations owing to Mepco by counterparties (triggered by the cancellation of the related service contracts), net of write-downs and reserves made through the recognition of vehicle service contract counterparty contingency expense, is recorded on our consolidated statements of financial condition as vehicle service contract counterparty receivables. At June 30, 2010, this amount totaled \$25.4 million (which includes a net balance of \$17.5 million from the single counterparty described above). This compares to a balance of \$5.4 million at December 31, 2009. As a result, 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.

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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 balance sheet date. However, because of the uncertainty surrounding the numerous and complex assumptions made, actual losses could exceed the charges we have taken to date.

In addition, several of these vehicle service contract marketers, including the counterparty described above and other companies, from which Mepco has purchased payment plans, have been sued or are under investigation for alleged violations of telemarketing laws and other consumer protection laws. The actions have been brought primarily by state attorneys general and the Federal Trade Commission but there have also been class action and other private lawsuits filed. In some cases, the companies have been placed into receivership or have discontinued business. In addition, the allegations, particularly those relating to blatantly abusive telemarketing practices by a relatively small number of marketers, have resulted in a significant amount of negative publicity that has adversely affected and may in the future continue to adversely affect sales and customer cancellations of purchased products throughout the industry, which have already been negatively impacted by the economic recession. It is possible these events could also cause federal or state lawmakers to enact legislation to further regulate the industry.

The above described events have had and may continue to have an adverse impact on Mepco in several ways. First, we face increased risk with respect to certain counterparties defaulting in their contractual obligations to Mepco which could result in additional charges for losses if these counterparties go out of business. Second, these events have negatively affected sales and customer cancellations in the industry, which has had and is expected to continue to have a negative impact on the profitability of Mepco's business. In addition, if any federal or state investigation is expanded to include finance companies such as Mepco, Mepco will face additional legal and other expenses in connection with any such investigation. An increased level of private actions in which Mepco is named as a defendant will also cause Mepco to incur additional legal expenses as well as potential liability. Finally, Mepco has incurred and will likely continue to incur additional legal and other expenses, in general, in dealing with these industry problems. Net payment plan receivables totaled \$285.7 million (or approximately 10.4% of total assets) and \$406.3 million (or approximately 13.7% of total assets) at June 30, 2010 and December 31, 2009, respectively. We expect that the amount of total payment plan receivables will continue to decline during the remainder of 2010, due to our desire to reduce payment plan receivables as a percentage of total assets. This decline in payment plan receivables is expected to adversely impact our net interest income and net interest margin.

Loan and collection expenses decreased by \$0.4 million to \$2.8 million and increased by \$0.3 million to \$7.6 million during the three- and six-month periods ended June 30, 2010, respectively, compared to 2009. The decrease in loan and collection expenses in the second quarter of 2010 is primarily due to a \$0.9 million reversal of a reserve established in the first quarter of 2010 at Mepco related to debtor in possession financing that is being provided to a counterparty that filed for bankruptcy in March 2010. In late May 2010, the U.S. Bankruptcy Court handling the case issued a final order authorizing Mepco's post petition financing on a super priority basis. In addition, subsequent to the issuance of this final order, the chief restructuring officer for the bankrupt counterparty identified sufficient assets which are likely to be recovered to fully repay Mepco's post petition financing. At June 30, 2010, Mepco had

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recorded a receivable of \$3.0 million related to this financing and associated professional fees (including the \$0.9 million that had been advanced in the first quarter of 2010). This receivable is included in Accrued income and other assets at June 30, 2010 in our Statement of Financial Condition. The increase in loan and collection expenses on a year to date basis primarily reflects a \$0.3 million increase in collection related costs at Mepco associated with the acquisition and management of collateral securing receivables from vehicle service contract counterparties.

The current year levels of occupancy, net, data processing, furniture, fixtures and equipment, communications, supplies, and other non-interest expenses were generally comparable to or slightly lower than the prior year. Collectively, these expense categories declined by \$0.2 million, or 2.4%, and by \$0.6 million, or 3.0%, during the second quarter and first six months of 2010, respectively, compared to the year ago periods due primarily to our cost reduction efforts.

Although losses on ORE and repossessed assets declined on a comparative quarterly basis, they were higher on a year-to-date comparative basis and remain at elevated levels. These losses principally reflect continuing weak prices for real estate. (See Portfolio Loans and asset quality.)

FDIC deposit insurance expense declined on both a comparative quarterly and year-to-date basis. The second quarter of 2009 included a one-time industry-wide special assessment of \$1.4 million. This special assessment was equal to 5 basis points on total assets less Tier 1 capital. Absent this 2009 special assessment, FDIC deposit insurance expense would have increased in 2010, reflecting higher assessment rates and a rise in the average balance of total deposits.

Credit card and bank service fees decreased on a comparative quarterly basis primarily due to an decrease in the number of payment plans being serviced by Mepco in the second quarter of 2010 compared to the second quarter of 2009. The level of such fees were similar on a year-to-date comparative basis. We expect the level of such fees to decrease during the last half of 2010 as payment plan receivables decline.

Legal and professional fees increased on both a comparative quarterly and year-to-date basis. This increase is primarily due to expenses associated with the issues described above related to Mepco and due to various regulatory matters.

Total advertising expense was substantially lower on both a quarterly and year-to-date comparative basis in 2010 compared to 2009 due primarily to a reduction in outdoor advertising (billboards) and the elimination of our VISA check card rewards program.

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 the majority of our net deferred tax assets. Accordingly, we are not recognizing much income tax expense (benefit) related to any income (loss) before income tax. We recorded an income tax expense of \$0.2 million and an income tax (benefit) of \$(0.1) million in the second quarter and first six months of 2010, respectively. This compares to income tax (benefits) of \$(1.0) million and of \$(0.7) million in the second quarter and first six months of 2009, respectively. Income tax benefits recognized have been 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. Generally, the calculation for income tax expense (benefit) does not consider the tax effects of changes in other comprehensive income or loss, which is a component

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of shareholders' equity on the balance sheet. However, an exception is provided in certain circumstances, such as when there is a pre-tax loss from continuing operations. In such case, pre-tax income from other categories (such as changes in OCI) is included in the calculation of tax expense for the current year. For the second quarter and first six months of 2010, this resulted in an income tax expense (benefit) of \$0.1 million and \$(0.1) million, respectively. For the second quarter and first six months of 2009, this resulted in an income tax (benefit) of \$(1.6) million and \$(1.6) million, respectively.

Income tax expense in the consolidated statements of operations also includes income taxes in a variety of other states due primarily to Mepco's operations. The amounts of such state income taxes were \$0.1 million and \$0.1 million in the second quarter and first six months of 2010, respectively. This compares to \$0.4 million and \$0.6 million in the second quarter and first six months of 2009, respectively. The decline in such state income taxes is due to a decline in Mepco's pre-tax income. (See **Business Segments** below.)

The capital initiatives summarized in **Introduction** and detailed under **Liquidity and capital resources** may trigger an ownership change that would negatively affect our ability to utilize our net operating loss carryforward and other deferred tax assets in the future. As a result, we may suffer higher-than-anticipated tax expense, and consequently lower net income and cash flow, in future years. As of June 30, 2010, we had a federal net operating loss carryforward of approximately \$40.8 million. 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 4.01%) and the sum of the values of our common shares and of our outstanding preferred stock, immediately before the ownership change. In addition to limits on the use of our net operating loss carryforward, 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. At this time, we do not know whether we will be successful in completing all of the initiatives as proposed and therefore do not know the likelihood of experiencing a change of ownership under these tax rules.

Since we currently have a valuation allowance intended to fully offset our net operating loss carryforward and the majority of other net 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.

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.

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

Business Segments

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
	(in thousands)			
Independent Bank	\$ (9,076)	\$ (8,422)	\$ (21,118)	\$ (29,567)
Mepco	477	4,995	1,146	9,580
Other ⁽¹⁾	16,506	(1,998)	14,066	(4,011)
Elimination	(23)	264	(47)	240
Net income (loss)	\$ 7,884	\$ (5,161)	\$ (5,953)	\$ (23,758)

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

The decrease in the year-to-date net loss recorded by Independent Bank in 2010 compared to 2009 is primarily due to a lower provision for loan losses that was partially offset by a decline in net interest income. (See Provision for loan losses, Portfolio Loans and asset quality, and Net interest income.)

Mepco's net income declined in 2010 compared to 2009 due primarily to a decrease in net interest income and increases in vehicle service contract payment plan counterparty contingencies expense (see 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 was increased to the Prime Rate (currently 3.25%) effective January 1, 2010. Prior to 2010, this intercompany loan was priced principally based on Brokered Certificate of Deposit (CD) rates.

The significant change in Other in the Business Segments table above is due primarily to the \$18.1 million gain on the extinguishment of debt that was recorded at the parent company in the second quarter of 2010.

Financial Condition

Summary. Our total assets decreased by \$228.2 million during the first six months of 2010. Loans, excluding loans held for sale (Portfolio Loans), totaled \$2.033 billion at June 30, 2010, down 11.6% from \$2.299 billion at December 31, 2009. (See Portfolio Loans and asset quality.)

Deposits totaled \$2.377 billion at June 30, 2010, compared to \$2.566 billion at December 31, 2009. The \$188.6 million decline in total deposits during this period is primarily due to a decrease in Brokered CDs that was partially offset by an increase in savings and checking accounts. Other borrowings totaled \$133.4 million at June 30, 2010, which is largely unchanged from December 31, 2009. Subordinated debentures totaled \$50.2 million at June 30, 2010, compared to \$92.9 million at December 31, 2009. This \$42.7 million decline relates to the exchange of our common stock for certain trust preferred securities completed in June 2010 and the corresponding cancellation of the related subordinated debentures issued by our parent company.

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Securities. We maintain diversified securities portfolios, which include obligations of the U.S. Treasury, U.S. government-sponsored agencies, securities issued by states and political subdivisions, corporate securities, mortgage-backed securities and other asset-backed 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 as follows, 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 believe that 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 Losses (in thousands)		Fair Value
Securities available for sale				
June 30, 2010	\$118,235	\$ 882	\$ 6,170	\$112,947
December 31, 2009	171,049	3,149	10,047	164,151

Securities available for sale declined during 2010 because sales, maturities and principal payments in the portfolio were not entirely replaced with new purchases. We sold municipal securities in 2010 and 2009 primarily because our current tax situation (net operating loss carryforward) negates the benefit of holding tax exempt securities. In 2010, we also sold certain agency and private-label residential mortgage-backed securities and bank trust preferred securities to augment our liquidity. (See Liquidity and capital resources.)

We did not record any other than temporary impairment charges on securities in the second quarter of 2010 or 2009. We recorded other than temporary impairment charges on securities of \$0.1 million and \$0.02 million during the first quarter of 2010 and 2009, 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. The 2010 charge related to a trust preferred security and a private label residential mortgage-backed security. The 2009 charge related to a trust preferred security. (See Non-interest income and Asset/liability management.)

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
	(in thousands)			
Proceeds	\$69,270	\$20,729	\$94,685	\$27,163
Gross gains	\$ 1,572	\$ 2,610	\$ 1,876	\$ 2,835
Gross losses	(187)	(101)	(221)	(107)
Impairment charges			(118)	(17)
Fair value adjustments	(22)	1,721	(27)	938
Net gains (losses)	\$ 1,363	\$ 4,230	\$ 1,510	\$ 3,649

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.

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 have experienced an elevated provision for loan losses in 2010 and 2009 compared to prior historical levels before 2007.

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 real estate 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. Overall loan demand has slowed since 2007, reflecting weak economic conditions in Michigan. 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 very poor economic climate for real estate development, particularly residential real estate. In addition, payment plan receivables declined in 2010 as we seek to reduce Mepco's vehicle service contract payment plan business. (See Non-interest expense.) Declines in Portfolio Loans or competition that leads to lower relative pricing on new Portfolio Loans could adversely impact our future operating results.

Table of Contents**Non-performing assets⁽¹⁾**

	June 30, 2010	December 31, 2009
	(dollars in thousands)	
Non-accrual loans	\$ 84,158	\$ 105,965
Loans 90 days or more past due and still accruing interest	356	3,940
Total non-performing loans	84,514	109,905
Other real estate and repossessed assets	41,785	31,534
Total non-performing assets	\$126,299	\$ 141,439
As a percent of Portfolio Loans		
Non-performing loans	4.16%	4.78%
Allowance for loan losses	3.72	3.55
Non-performing assets to total assets	4.61	4.77
Allowance for loan losses as a percent of non-performing loans	89.46	74.35

⁽¹⁾ Excludes loans classified as troubled debt restructured that are not non-performing.

The decrease in non-performing loans since year-end 2009 is 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 during the first half of 2010. Non-performing commercial loans relate largely to delinquencies caused by cash-flow difficulties encountered by real estate developers (due to a decline in sales of real estate) as well as owners of income-producing properties (due to higher vacancy rates and/or lower rental rates). Non-performing commercial loans have declined for the past six quarters. The elevated level of non-performing residential mortgage loans is primarily due to delinquencies reflecting both weak economic conditions and soft residential real estate values in many parts of Michigan. However, retail non-performing loans have declined for four consecutive quarters and are at their lowest level since the first quarter of 2009.

ORE and repossessed assets totaled \$41.8 million at June 30, 2010, compared to \$31.5 million at December 31, 2009. This increase is the result 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 weak economic conditions and declining residential real estate values (which has eroded or eliminated the equity that many mortgagors had in their home). Because the redemption period on foreclosures is relatively long in Michigan (six months to one year) and we have many non-performing loans that were in the process of foreclosure at June 30, 2010, we anticipate that our level of ORE and repossessed assets will likely remain at elevated levels for some period of time. An elevated level of non-performing assets adversely impacts our net interest income.

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 3.33% on an annualized basis in the first half of 2010 compared to 3.98% in the first half of 2009. The decline in loan net charge-offs primarily reflects a decrease of \$12.7 million for commercial loans. The reduced level of commercial loan net charge-offs principally reflects a decline in the level of non-performing commercial loans. The commercial loan portfolio is thoroughly analyzed each quarter through our credit review process and an appropriate allowance and provision for loan losses is recorded based on such review and in light of prevailing market and loan collection conditions.

	Six months ended June 30,			
	2010			2009
	Loans	Unfunded Commitments	Loans	Unfunded Commitments
	(dollars in thousands)			
Balance at beginning of period	\$81,717	\$1,858	\$57,900	\$2,144
Additions (deduction)				
Provision for loan losses	29,694		55,783	
Recoveries credited to allowance	1,839		1,494	
Loans charged against the allowance	(37,644)		(49,906)	
Additions (deductions) included in non-interest expense		336		(152)
Balance at end of period	\$75,606	\$2,194	\$65,271	\$1,992

Net loans charged against the allowance to average

Portfolio Loans (annualized)	3.33%	3.98%
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In determining the allowance and the related provision for credit losses, we consider four principal elements: (i) specific allocations based upon probable incurred 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 allowance allocations based on subjective factors, including local and general economic business factors and trends, portfolio concentrations and changes in the size, mix and the general terms of the loan portfolios.

The first element 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.

The second element reflects the application of our loan rating system. This rating system is similar to those employed by state and federal banking regulators. 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. For higher rated loans (non-watch credit) we again determine a probability of default and loss given default in order to apply an allocation percentage.

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The third element is determined by assigning allocations to homogeneous loan groups based principally upon the five-year average of loss experience for each type of loan. Recent years are weighted more heavily in this average. Average losses may be further adjusted based on an analysis of delinquent loans. Loss analyses are conducted at least annually.

The fourth element 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 loan portfolios. (See Provision for credit losses.)

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 vehicle service contract payment plans are included in the provision for loan losses. Mepco recorded a credit of \$0.2 million for its provision for loan losses in the first half of 2010 due primarily to a significant decline (\$120.6 million) in the balance of payment plan receivables. This compares to a provision for losses of \$0.3 million in the first half of 2009. Mepco's allowance for losses totaled \$0.5 million and \$0.8 million at June 30, 2010 and December 31, 2009, 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 contact is 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 allowance for loan losses decreased \$6.1 million from \$81.7 million at December 31, 2009 to \$75.6 million at June 30, 2010 and was equal to 3.72% of total Portfolio Loans at June 30, 2010 compared to 3.55% at December 31, 2009. Three of the four components of the allowance for loan losses outlined above declined during the first half of 2010. The allowance for loan losses related to specific loans increased due to a \$10.2 million increase in loss allocations on troubled debt restructured credits which totaled \$18.8 million at June 30, 2010, compared to \$8.6 million at December 31, 2009. This increase is due in part to a \$34.4 million increase in the balance of these loans during the first six months of 2010 which totaled \$112.2 million at June 30, 2010, compared to \$77.8 million at December 31, 2009. This increase was partially offset by a decline in loss allocations on individual commercial credits. The allowance for loan losses related to other adversely rated loans decreased \$5.1 million from December 31, 2009 to June 30, 2010 primarily due to a \$18.3 million decrease in the balance of such loans from \$140.4 million at December 31, 2009 to \$122.1 million at June 30, 2010, with the most significant decrease occurring in non-impaired substandard commercial loans with balances of over \$1 million, which decreased \$16.2 million from \$19.5 million at December 31, 2009 to \$3.3 million at June 30, 2010. The allowance allocation determined on these loans, based on discounted collateral or cash flow analysis, was reduced \$4.4 million from \$6.0 million at December 31, 2009 to \$1.6 million at June 30, 2010. The allowance for loan losses related to historical losses decreased due to declines in loan balances, as total loans declined \$266.4 million from \$2.299 billion at December

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31, 2009 to \$2.033 billion at June 30, 2010. Finally, the allowance for loan losses related to subjective factors decreased slightly primarily due to the improvement in certain economic indicators used in computing this portion of the allowance.

Allocation of the Allowance for Loan Losses

	June 30, 2010	December 31, 2009
	(in thousands)	
Specific allocations	\$30,099	\$29,593
Other adversely rated loans	9,392	14,481
Historical loss allocations	21,740	22,777
Additional allocations based on subjective factors	14,375	14,866
	\$75,606	\$81,717

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 high-performance checking program that utilizes a combination of direct mail solicitations, in-branch merchandising, gifts for customers opening new checking accounts or referring business to our bank and branch staff sales training. This program has historically generated increases in customer relationships as well as deposit service charges. Over the past two to three 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 short-term borrowings. As a result, funding Portfolio Loans with alternative sources of funds (as opposed to core deposits) may erode certain of our profitability measures, such as return on assets, and may also adversely impact our liquidity. (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 prepaid deposit insurance premium assessments totaled \$18.8 million and \$22.0 million at June 30, 2010 and December 31, 2009, respectively, and will be expensed over the assessment period (through the fourth quarter of 2012). 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 deposit balances and assessment rates used during each assessment period.

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

Table of Contents**Alternative Sources of Funds**

	Amount	June 30, 2010 Average Maturity	Rate	Amount	December 31, 2009 Average Maturity	Rate
			(dollars in thousands)			
Brokered CDs ⁽¹⁾	\$422,749	2.5 years	2.95%	\$629,150	2.2 years	2.46%
Fixed rate FHLB advances ⁽¹⁾	23,275	5.9 years	6.41	27,382	5.5 years	6.59
Variable rate FHLB advances ⁽¹⁾	75,000	1.2 years	0.48	67,000	1.4 years	0.32
Securities sold under agreements to repurchase ⁽¹⁾	35,000	.4 years	4.42	35,000	.9 years	4.42
Total	\$556,024	2.3 years	2.86%	\$758,532	2.2 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, principally advances from the Federal Home Loan Bank (the FHLB) and securities sold under agreements to repurchase (Repurchase Agreements), totaled \$133.4 million at June 30, 2010, compared to \$131.2 million at December 31, 2009. The \$2.2 million increase in other borrowed funds principally reflects additional borrowings from the FHLB.

As described above, we rely on wholesale funding, including FRB and FHLB borrowings and Brokered CDs to augment our core deposits to fund our business. As of June 30, 2010, our use of such wholesale funding sources amounted to approximately \$556.0 million. Because wholesale funding sources are affected by general market conditions, the availability of funding from wholesale lenders may be dependent on the confidence these investors 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 will 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. 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.

In addition, if we fail to remain well-capitalized (under federal regulatory standards) which is likely if we are unable to successfully raise additional capital as outlined below, we will be prohibited from accepting or renewing Brokered CDs without the prior consent of the FDIC. As of June 30, 2010, we had Brokered CDs of approximately \$422.7 million. Of this amount \$60.3 million mature during the next twelve months. As a result, any such restrictions on our ability to access Brokered CDs may have a material adverse impact on our business and financial condition.

Moreover, 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 in the FDIC Transaction Account Guarantee Program (TAGP), which is set to expire on December 31, 2010, may be particularly susceptible to outflow (although the Dodd-Frank Act extended protection similar to that provided under the TAGP through December 31, 2012 for only non-interest bearing transaction accounts). At June 30, 2010 we had \$88.1 million of uninsured deposits and an additional \$174.3 million of deposits in the TAGP. A reduction in core deposits

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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.

Our financial performance will be materially affected if we are unable to maintain our access to funding or if we are required to rely more heavily on more expensive funding sources. In such case, our net interest income and results of operations would be adversely affected.

We employ derivative financial instruments to manage our exposure to changes in interest rates. At June 30, 2010, we employed interest-rate swaps with an aggregate notional amount of \$20.0 million and interest rate caps with an aggregate notional amount of \$35.0 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 consolidated statements of cash flows categorize these sources and uses into operating, investing and financing activities. We primarily focus our liquidity management on developing access to a variety of borrowing sources to supplement our deposit gathering activities as well as maintaining sufficient short-term liquid assets (primarily overnight deposits with the FRB) in order to be able to respond to unforeseen liquidity needs.

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

At June 30, 2010 we had \$413.2 million of time deposits that mature in the next twelve months. Historically, a majority of these maturing time deposits are renewed by our customers or are Brokered CDs that we expect to replace. Additionally \$1.417 billion of our deposits at June 30, 2010 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. There can be no assurance that historical patterns of renewing time deposits or overall growth 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 FDIC announced several programs including increasing the deposit insurance limit from \$100,000 to \$250,000 at least until December 31, 2013 and providing unlimited deposit insurance for balances in non-interest bearing demand deposit and certain low interest rate transaction accounts until December 31, 2010 (see discussion of TAGP above). The Dodd-Frank Act makes the increase in the deposit insurance limit from \$100,000 to \$250,000 permanent and extends protection similar to that provided under the TAGP for only noninterest bearing transaction accounts through December 31, 2012. 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 these moves by the FDIC and our proactive communications efforts, the potential outflow of deposits remains as a significant liquidity risk, particularly since our recent 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 outflow of

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significant amounts of deposits could have an adverse impact on our liquidity and results of operations.

We have developed contingency funding plans that stress tests our liquidity needs that may arise from certain events such as an adverse credit event or a disaster recovery situation. Our liquidity management also includes periodic monitoring that segregates assets between liquid and illiquid and classifies liabilities as core and non-core. This analysis compares our total level of illiquid assets to our core funding. It is our goal to have core funding sufficient to finance illiquid assets.

As a result of the liquidity risks described above and in *Deposits and borrowings* we have increased our level of overnight cash balances in interest-bearing accounts to \$303.3 million at June 30, 2010 from \$223.5 million at December 31, 2009 and \$19.2 million at June 30, 2009. We have also issued longer-term (two to five years) callable Brokered CDs and reduced certain secured borrowings (such as from the FRB) to increase available funding sources. We believe these actions will assist us in meeting our liquidity needs during 2010.

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 preferred stock.

We have four special purpose entities that originally issued \$90.1 million of cumulative trust preferred securities outside of IBC. On June 23, 2010, we exchanged 51.1 million shares of our common stock (having a fair value of approximately \$23.5 million on the date of the 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 June 30, 2010, \$48.7 million of cumulative trust preferred securities remained outstanding. These entities have also issued common securities and capital to IBC that in turn, issued subordinated debentures to these special purpose entities equal to the trust preferred securities, common securities and capital issued. The subordinated debentures represent the sole asset of the special purpose entities. The common securities, capital and subordinated debentures are included in our Consolidated Statements of Financial Condition at June 30, 2010 and December 31, 2009.

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) is 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 the Tier 2 capital, subject to restrictions. Currently, at IBC, \$48.0 million of these securities qualify as Tier 1 capital.

In December 2008, we issued 72,000 shares of Series A, no par value, \$1,000 liquidation amount, fixed rate cumulative perpetual preferred stock (*Series A Preferred Stock*) and a warrant to purchase 3,461,538 shares (at \$3.12 per share) of our common stock (*Original Warrant*) to the UST in return for \$72.0 million under the TARP CPP. 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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As described earlier, on April 16, 2010, we exchanged the Series A Preferred Stock for our Series B Preferred Stock and amended and restated the Original Warrant. 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.

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, our authorized number of directors will be automatically increased by two and the holders of the Series B Preferred Stock, voting together with holders of any then outstanding voting parity stock, will have the right to elect those 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.

Under the terms of the Series B Preferred Stock, the UST (and any subsequent holder of the Series B Preferred Stock) will have the right to convert the Series B Preferred Stock into our common stock at any time. In addition, we will 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 \$40.0 million aggregate original liquidation amount of the trust preferred securities issued by our trust subsidiaries, IBC Capital Finance II, IBC Capital Finance III, IBC Capital Finance IV, and Midwest Guaranty Trust I (this was accomplished on June 23, 2010);
- (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.

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 \$0.7234, 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, provided that such Conversion Rate is subject to certain anti-dilution adjustments.

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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 shares of 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 \$0.8 million at June 30, 2010.

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 144.0 million, unless we receive shareholder approval to issue a greater number of shares.

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 prior to the first dividend payment date falling on or after the second anniversary of the original issue date, the redemption price will be equal to the \$1,000 liquidation amount per share plus any accrued and unpaid dividends. If the Series B Preferred Stock is redeemed on or after such date, 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 shares of Series B Preferred Stock originally issued to the Treasury, unless fewer of such shares are then outstanding (in which case all of the Series B Preferred Stock must be redeemed).

In connection with the issuance of the Series B Preferred Stock, on April 16, 2010, we amended our Articles of Incorporation to designate the Series B Preferred Stock, and to specify the preferences and rights of that series, including the relevant provisions described above.

The Amended Warrant is exercisable, in whole or in part, by the UST (and any subsequent holder of the Amended Warrant), at any time or from time to time after April 16, 2010, but in no event later than December 12, 2018. The exercise price (\$0.7234) and the number of shares (3,461,538) subject to the Amended Warrant are both subject to anti-dilution adjustments.

We recorded the exchange of the Series A Preferred Stock for the Series B Preferred Stock and the exchange of the Original Warrant for the Amended Warrant in the second quarter of 2010 based on the relative fair values of these newly issued instruments.

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In the fourth quarter of 2009, we took certain actions to improve our regulatory capital ratios and preserve capital and liquidity. Beginning in November of 2009, we eliminated the \$0.01 per share quarterly cash dividend on our common stock. In addition, 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 \$3.7 million per year until December of 2013, at which time they would increase to \$6.7 million per year. Also beginning in December of 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 June 30, 2010, amount to approximately \$2.0 million per year. These actions will preserve cash at our parent company as we do not expect Independent Bank, our bank subsidiary, 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, and described herein.

We do not have any current plans to resume dividend payments on our outstanding trust preferred securities or the outstanding shares of any preferred stock. We do not know if or when any such payments will resume.

The terms of the Debentures and trust indentures (the Indentures) related to our trust preferred securities allow us to defer payment of interest on the Debt Securities 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.

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 whatsoever 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) 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, other than purchases, redemptions or other acquisitions of our common stock or other junior stock in connection with the administration of employee benefit plans in the ordinary course of business and consistent with past practice; pursuant to a publicly announced repurchase plan up to the increase in diluted shares outstanding resulting from the grant, vesting or exercise of equity-based compensation; any dividends or distributions of rights or junior stock in connection with any shareholders rights plan, redemptions or repurchases of rights pursuant to any shareholders rights plan; acquisition of record ownership of common stock or other junior stock or parity stock for the beneficial ownership of any other person who is not us or one of our subsidiaries, including as trustee or custodian; and the exchange or conversion of common stock or other junior stock for or into other junior stock or of parity stock for or into other parity stock or junior stock but only to the extent that such acquisition is required pursuant to binding contractual agreements entered into before December 12, 2008 or any subsequent agreement for the accelerated exercise, settlement or exchange thereof for common stock.

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During the deferral period on the Debentures and Series B Preferred Stock, 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.

Shareholders' equity applicable to common stock increased to \$59.2 million at June 30, 2010 from \$40.7 million at December 31, 2009. Our tangible common equity (TCE) totaled \$49.6 million and \$30.4 million, respectively, at those same dates. Our ratio of TCE to tangible assets was 1.82% at June 30, 2010 compared to 1.03% at December 31, 2009. We have taken various steps in order to further increase our TCE and regulatory capital ratios as described below. Although our subsidiary bank's regulatory capital ratios remain at levels above well capitalized standards, because of: (a) the losses that we have incurred in recent quarters; (b) our elevated levels of non-performing loans and other real estate; and (c) the ongoing economic stress in Michigan, we have taken the following actions to improve our regulatory capital ratios and preserve liquidity at our parent company level:

Eliminated our cash dividend on our common stock;

Deferred the dividends on our Series B Preferred Stock;

Deferred the dividends on our Debentures;

Exchanged the Series A Preferred Stock for Series B Convertible Preferred Stock in April 2010; and

Completed the exchange of 51.1 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 in June 2010.

The actions taken with respect to the payment of dividends on our capital instruments as described above will preserve cash at our parent company as we do not expect our bank subsidiary to be able to pay any cash dividends in the near term. 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.

In December 2009, the Board of Directors of IBC adopted resolutions 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 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, our subsidiary bank, adopted resolutions 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 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 troubled debt restructurings;

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 condition and operations that we believe most require our focus at this time. It is very possible that if we had not adopted these resolutions, the FRB and the OFIR may have imposed similar requirements on us through a memorandum of understanding or similar undertaking. We are not currently subject to any such regulatory agreement or enforcement action. However, we believe that if we are unable to substantially comply with the resolutions set forth above and if our financial condition and performance do not otherwise materially improve, we may face additional regulatory scrutiny and restrictions in the form of a memorandum of understanding or similar undertaking imposed by the regulators.

Subsequent to the adoption of the resolutions described above, the Bank adopted the capital restoration plan required by the resolutions (the Capital Plan) and submitted such Capital Plan to the FRB and the OFIR. This Capital Plan is described in more detail below. Other than fully implementing such Capital Plan and achieving the minimum capital ratios set forth in the resolutions, we believe we have already taken appropriate actions to fully comply with these Board resolutions.

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 of June 30, 2010, our Bank continued to meet the requirements to be considered well-capitalized under federal regulatory standards. However, 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 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 subsidiary bank as of June 30, 2010, the minimum capital ratios imposed by the Board resolutions, and the minimum ratios necessary to be considered well-capitalized under federal regulatory standards:

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	Independent Bank Actual at 6/30/10	Minimum Ratios Established by our Board	Ratios Required to be Well- Capitalized
Total capital to risk weighted assets	10.55%	11.0%	10.0%
Tier 1 capital to average assets	6.37%	8.0%	5.0%

The Capital Plan (as modified in mid-2010) sets forth an objective of achieving these minimum capital ratios as soon as practicable, but no later than September 30, 2010, and maintaining such capital ratios through at least the end of 2012.

The Capital Plan includes projections prepared by us that reflect forecasted financial data through 2012. The projections take into account the various risks and uncertainties we face. However, because the projections are based on assumptions regarding such risks and uncertainties, which assumptions may not prove to be true, the Capital Plan contains a target of \$100 million to \$125 million of additional capital to be raised by us.

In anticipation of the capital raising initiatives described in the Capital Plan, we engaged an independent third party to perform a due diligence review (a stress test) on our commercial loan portfolio and a separate independent third party to perform a similar review of our retail loan portfolio. These independent stress tests were concluded in January 2010. Each analysis included different scenarios based on expectations of future economic conditions. We engaged these independent reviews in order to ensure that the similar analyses we had performed internally in 2009, on which we based our projections for future expected loan losses and our need for additional capital, were reasonable and did not materially understate our projected loan losses. Based on the conclusions of these third party reviews, we determined that we did not need to modify our projections used for purposes of the Capital Plan.

In addition to contemplating a public offering of our common stock for cash, the Capital Plan sets forth two other primary capital raising initiatives: (1) an offer to exchange shares of our common stock for any or all of our outstanding trust preferred securities; and (2) the exchange of shares of our common stock for any or all of the shares of preferred stock held by the UST. The additional initiatives are designed to improve our ratio of TCE to tangible assets, reduce required annual interest and dividend payments by reducing the aggregate principal amount of outstanding trust preferred securities and outstanding shares of preferred stock, and otherwise improve our ability to successfully raise additional capital through a public offering of our common stock.

As described above, on April 16, 2010, we closed a transaction with the UST for the exchange of the \$72 million of Series A Preferred Stock that the UST acquired pursuant to the TARP Capital Purchase Program for new shares of Series B Convertible Preferred Stock. A key benefit of this transaction was obtaining the right, under the terms of the new Series B Convertible Preferred Stock, to compel the conversion of this stock into shares of our common stock, provided we meet a number of conditions. The two primary conditions to our ability to compel a conversion of the preferred stock are the conversion of at least \$40 million of outstanding trust preferred securities into common stock and the receipt of net proceeds of at least \$100 million from a common stock offering to investors other than the UST. The first of these two primary conditions was satisfied on June 23, 2010, when we issued our common stock in exchange for \$41.4 million of certain trust preferred securities plus accrued and unpaid dividends on such securities.

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Our Capital Plan also outlines various contingency plans in case we do not succeed in raising all additional capital needed. These contingency plans include a possible further reduction in our assets (such as through a sale of branches, loans, and/or other operating divisions or subsidiaries), more significant expense reductions than those that have already been implemented and those that are currently being considered, and a sale of the Bank. Because of current market conditions, we believe we are more likely to meet the minimum capital ratios set forth in the Capital Plan through raising new equity capital than we are through pursuing any of these contingency plans. However, the 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 raise sufficient equity capital through the capital raising initiatives described above. The Capital Plan concludes with the recognition that our strategy and focus for the near term will be to improve our asset quality and pursue the capital raising initiatives described above in order to strengthen our capital position. 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 up to 15.0 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 after the registration statement referenced below becomes effective. 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. To date, no securities have been sold under the equity line facility. In connection with the Registration Rights Agreement with Dutchess, we have agreed to register for resale, the shares that may be sold to Dutchess. We expect to file a registration statement with the SEC for these shares on or before August 20, 2010.

Capitalization

	June 30, 2010	December 31, 2009
	(in thousands)	
Subordinated debentures	\$50,175	\$92,888
Amount not qualifying as regulatory capital	(1,507)	(2,788)
Amount qualifying as regulatory capital	48,668	90,100
Shareholders' Equity		
Preferred stock:		
Series A	--	69,157
Series B	70,458	--
Common stock	250,737	23,863
Capital surplus	--	201,618
Accumulated deficit	(177,242)	(169,098)
Accumulated other comprehensive loss	(14,281)	(15,679)
Total shareholders' equity	129,672	109,861
Total capitalization	\$178,340	\$199,961

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Total shareholders' equity at June 30, 2010 increased by \$19.8 million from December 31, 2009, due primarily to our exchange of common stock for trust preferred securities as described above, that was partially offset by our net loss of \$6.0 million for the first six months of 2010. Shareholders' equity totaled \$129.7 million, equal to 4.74% of total assets at June 30, 2010. At December 31, 2009, shareholders' equity was \$109.9 million, which was equal to 3.70% of total assets.

Our bank subsidiary remains well capitalized (as defined by banking regulations) at June 30, 2010.

Bank capital ratios

	June 30, 2010	December 31, 2009
Tier 1 capital to average assets	6.37%	6.72%
Tier 1 risk-based capital	9.27	9.08
Total risk-based capital	10.55	10.36

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 the balance sheet in a manner that is consistent with our mission to maintain profitable financial leverage within established risk parameters. We evaluate various opportunities and alternate balance-sheet 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 balance-sheet 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.

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 balance sheet. 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.

Table of Contents**Changes in Market Value of Portfolio Equity and Net Interest Income**

Change in Interest Rates	Market Value Of Portfolio Equity(1)	Percent Change (dollars in thousands)	Net Interest Income(2)	Percent Change
June 30, 2010				
200 basis point rise	\$ 163,200	18.52 %	\$ 112,600	1.26%
100 basis point rise	152,400	10.68	110,700	(0.45)
Base-rate scenario	137,700		111,200	
100 basis point decline	122,200	(11.26)	110,900	(0.27)
200 basis point decline	120,700	(12.35)	107,600	(3.24)
December 31, 2009				
200 basis point rise	\$ 160,500	16.14 %	\$ 134,000	2.52%
100 basis point rise	150,400	8.83	131,300	0.46
Base-rate scenario	138,200		130,700	
100 basis point decline	128,100	(7.31)	129,900	(0.61)
200 basis point decline	126,300	(8.61)	128,900	(1.38)

(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 balance
sheet, which
includes debt
and related
financial
derivative
instruments, and
do not consider
loan fees.

Management plans and expectations. As described earlier, we have adopted the Capital Plan which includes a series of actions designed to increase our common equity capital, decrease our expenses and enable us to withstand and better respond to current market conditions and the potential for worsening market conditions. However, based on our current forecasts, even absent additional capital, our bank subsidiary is expected to remain adequately capitalized throughout 2010 and our parent company would have sufficient cash on hand to meet expected obligations during 2010. These forecasts are based upon certain assumptions, including future levels of our provision for loan losses, vehicle service contract counterparty contingencies, the level of our risk based assets and other factors, and differences between our actual results and these assumptions will impact our actual capital levels.

Litigation Matters

We are involved in various litigation matters in the ordinary course of business and at the present time, we do not believe that any of these matters will have a significant impact on our financial condition or results of operation.

Table of Contents**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, derivative financial instruments, 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 financial position or results of operations.

We are required to assess our investment securities for other than temporary impairment on a periodic basis. The determination of other than temporary impairment for an investment security requires judgment as to the cause of the impairment, the likelihood of recovery and the projected timing of the recovery. The topic of other than temporary impairment was at the forefront of discussions within the accounting profession during 2008 and 2009 because of the dislocation of the credit markets that occurred. On January 12, 2009 the FASB issued ASC 325-40-65-1 (formerly Staff Position No. EITF 99-20-1 Amendments to the Impairment Guidance of EITF Issue No. 99-20.) This standard has been applicable to our financial statements since December 31, 2008. In particular, this standard strikes the language that required the use of market participant assumptions about future cash flows from previous guidance. This change now permits the use of reasonable management judgment about whether it is probable that all previously projected cash flows will not be collected in determining other than temporary impairment. Our assessment process resulted in recording no other than temporary impairment charges in our consolidated statements of operations during the second quarters of 2010 and 2009. We did record other than temporary impairment charges of \$0.1 million and \$0.02 million in the first quarters of 2010 and 2009, respectively, in our consolidated statements of operations. We believe that our assumptions and judgments in assessing other than temporary impairment for our investment securities are reasonable and conform to general industry practices. Prices for investment securities are largely provided by a pricing service. These prices consider benchmark yields, reported trades, broker / dealer quotes and issuer spreads. Furthermore, prices for mortgage-backed securities consider: TBA prices, monthly payment information and collateral performance. At June 30, 2010 the cost basis of our investment securities classified as available for sale exceeded their estimated fair value at that same date by \$5.3 million (compared to \$6.9 million at December 31, 2009). This amount is included in the accumulated other comprehensive loss section of shareholders equity.

Our methodology for determining the allowance and related provision for loan losses is described above in Portfolio Loans and asset quality. In particular, this area of accounting requires a significant amount of judgment because a multitude of factors can influence the ultimate collection of a loan or other type of credit. It is extremely difficult to precisely measure the amount of losses that are probable in our loan portfolio. We use a rigorous process to attempt to accurately quantify the necessary allowance and related provision for loan losses, but there can be no assurance that our modeling process will successfully identify all of the losses that are probable in our loan portfolio. As a result, we could record future provisions for loan losses that may be significantly different than the levels that we recorded in the second quarter and first half of 2010 and 2009, respectively.

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At June 30, 2010 we had approximately \$13.0 million of mortgage loan servicing rights capitalized on our balance sheet. There are several critical assumptions involved in establishing the value of this asset including estimated future prepayment speeds on the underlying mortgage loans, the interest rate used to discount the net cash flows from the mortgage loan servicing, the estimated amount of ancillary income that will be received in the future (such as late fees) and the estimated cost to service the mortgage loans. We believe the assumptions that we utilize in our valuation are reasonable based upon accepted industry practices for valuing mortgage loan servicing rights and represent neither the most conservative or aggressive assumptions. We recorded an increase in the valuation allowance on capitalized mortgage loan servicing rights of \$2.5 million in the second quarter of 2010 (compared to a decrease in such valuation allowance of \$3.0 million in the second quarter of 2009). Nearly all of our mortgage loans serviced for others at June 30, 2010 are for either Fannie Mae or Freddie Mac. Because of our current financial condition, 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.

We use a variety of derivative instruments to manage our interest rate risk. These derivative instruments may include interest rate swaps, collars, floors and caps and mandatory forward commitments to sell mortgage loans. Under FASB ASC Topic 815 Derivatives and Hedging the accounting for increases or decreases in the value of derivatives depends upon the use of the derivatives and whether the derivatives qualify for hedge accounting. At June 30, 2010 we had approximately \$30.0 million in notional amount of derivative financial instruments that qualified for hedge accounting under this standard. As a result, generally, changes in the fair value of those derivative financial instruments qualifying as cash flow hedges are recorded in other comprehensive income or loss. The changes in the fair value of those derivative financial instruments qualifying as fair value hedges are recorded in earnings and, generally, are offset by the change in the fair value of the hedged item which is also recorded in earnings (we currently do not have any fair value hedges). The fair value of derivative financial instruments qualifying for hedge accounting was a negative \$1.6 million at June 30, 2010.

Mepco purchases payment plans from companies (which we refer to as Mepco's counterparties) that provide vehicle service contracts and similar products to consumers. The payment plans (which are classified as payment plan receivables in our consolidated statements of financial condition) permit a consumer to purchase a 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 does not have recourse against the consumer for nonpayment of a payment plan and therefore does not evaluate the creditworthiness of the individual customer. When consumers stop making payments or exercise their right to voluntarily cancel the contract, the remaining unpaid balance of the payment plan is normally recouped by Mepco from the counterparties that sold the contract and provided the coverage. The refund obligations of these counterparties are not fully secured. We record losses in vehicle service contract counterparty contingencies expense, included in non-interest expenses, for estimated defaults by these counterparties in their obligations to Mepco. These losses (which totaled \$4.9 million and \$2.2 million in the second quarter of 2010 and 2009, respectively and \$8.3 million and \$3.0 million in the first half of 2010 and 2009, respectively) are titled vehicle service contract counterparty contingencies in our consolidated statements of operations. This area of accounting requires a significant amount of judgment because a number of factors can influence

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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 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 materially different than the levels that we recorded thus far in 2010 and 2009.

Our accounting for income taxes involves the valuation of deferred tax assets and liabilities primarily associated with differences in the timing of the recognition of revenues and expenses for financial reporting and tax purposes. At June 30, 2010 we had gross deferred tax assets of \$69.9 million, gross deferred tax liabilities of \$6.1 million and a valuation allowance of \$62.4 million (\$2.2 million of such valuation allowance was established during the six months ended June 30, 2010, \$24.0 million of which was established in 2009 and \$36.2 million of which was established in 2008) resulting in a net deferred tax asset of \$1.4 million. This valuation allowance represents our entire net deferred tax asset except for certain deferred tax assets at Mepco that relate to state income taxes and that can be recovered based on Mepco's individual earnings. We are required to assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a more likely than not standard. In accordance with this standard, we reviewed our deferred tax assets and determined that based upon a number of factors including our declining operating performance since 2005 and our net loss in 2009 and 2008, overall negative trends in the banking industry and our expectation that our operating results will continue to be negatively affected by the overall economic environment, we should establish a valuation allowance for our deferred tax assets. In the last quarter of 2008, we recorded a \$36.2 million valuation allowance, which consisted of \$27.6 million recognized as income tax expense and \$8.6 million recognized through the accumulated other comprehensive loss component of shareholders' equity and in 2009 we recorded an additional \$24.0 million valuation allowance (which is net of a \$4.1 million allocation of deferred taxes on the accumulated other comprehensive loss component of shareholders' equity). We had recorded no valuation allowance on our net deferred tax asset in prior years because we believed that the tax benefits associated with this asset would more likely than not, be realized. Changes in tax laws, changes in tax rates and our future level of earnings can impact the ultimate realization of our net deferred tax asset as well as the valuation allowance that we have established.

At June 30, 2010 and December 31, 2009 we had no remaining goodwill. Prior to January 1, 2010, we tested our goodwill for impairment and our accounting for goodwill was a critical accounting policy.

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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 June 30, 2010, have concluded that, as of such date, our disclosure controls and procedures were effective.

(b) Changes in Internal Controls.

During the quarter ended June 30, 2010, 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, 2009, as updated in Part II Item 1A of our quarterly report on Form 10-Q for the quarter ended March 31, 2010, except as follows:

Developments in connection with the implementation of our Capital Plan reflect the challenges we face in achieving the objectives of that plan, which we believe are very important to our future financial success.

One of the primary capital raising initiatives set forth in our Capital Plan consists of the conversion of the preferred stock held by the UST into shares of our common stock. As disclosed under Management's Discussion and Analysis of Financial Condition and Results of Operations above, on April 16, 2010, we issued to the UST (1) 74,426 shares of our newly issued Series B Preferred Stock, and (2) an Amended Warrant. These were issued in exchange for all of the Series A Preferred Stock and the Original Warrant, plus approximately \$2.4 million in accrued and unpaid dividends on such Series A Preferred Stock.

Under the terms of the Series B Preferred Stock, the UST (and any subsequent holder of the Series B Preferred Stock) will have the right to convert the Series B Preferred Stock into our common stock at any time. In addition, we will 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 \$40.0 million aggregate original liquidation amount of the trust preferred securities issued by our 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.

Although such a conversion is one of the primary capital raising initiatives set forth in our Capital Plan, there can be no assurance that we will be able to satisfy the conditions described above or that the UST would be willing to waive any of the conditions or otherwise exercise its right to convert the Series B Preferred Stock.

Although we have successfully satisfied the condition described in clause (ii) of the preceding paragraph, we have not yet conducted a stock offering resulting in cash proceeds to us of at least \$100 million. Our ability to complete such an offering, if and when one is commenced, may not be successful.

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Our financial condition may result in a suspension of our selling and servicing contract with Fannie Mae, which could have a material and adverse effect on our financial condition and results of operations.

Because of our financial condition at March 31, 2010, we received a letter from Fannie Mae in May 2010 advising us that we were in breach of our selling and servicing contract with Fannie Mae. The letter states that if this breach is not remedied as evidenced by our call report as of June 30, 2010, Fannie Mae will suspend our servicing contract. The suspension of our contract with Fannie Mae could have a material adverse impact on our financial condition and results of operations. We are in discussions with Fannie Mae to address the concerns in its May 2010 letter and avoid any suspension of our contract; however, this matter remains unresolved and the risk exists that Fannie Mae may require us to very quickly sell or transfer mortgage 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 future earnings prospects. Although we have not received any notice from Freddie Mac similar to the notice we received from Fannie Mae, a similar type of action could be taken by Freddie Mac.

The Dodd-Frank Wall Street Reform and Consumer Protection Act may have a material, adverse effect on our business, future results of operations, and financial condition.

On July 21, 2010, the Dodd-Frank Act was signed into law. This new law will result in a number of new regulatory changes that could impact us. The law includes, among other things, provisions establishing a Bureau of Consumer Financial Protection, which will have broad authority to develop and implement rules regarding most consumer financial products; provisions affecting corporate governance and executive compensation at all publicly traded companies; provisions that would broaden the base for FDIC insurance assessments and permanently increase FDIC deposit insurance to \$250,000; and new restrictions on how mortgage brokers and loan originators may be compensated. When implemented, these provisions as well as any other changes to laws or regulations applicable to us may impact our business operations and may negatively affect our earnings and financial condition by affecting our ability to offer certain products or earn certain fees and by exposing us to increased compliance and other costs. Many aspects of the new law require federal regulatory authorities to issue regulations that have not yet been issued, so the full impact of the Dodd-Frank Act is not yet known.

Item 3b. Defaults Upon Senior Securities

As of June 30, 2010, the Company was in arrears in the aggregate amount of \$0.3 million with respect to the Series B Preferred Stock it issued to the U.S. Department of Treasury as a result of the Company's decision to currently defer these dividends.

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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 either directly or by incorporation by reference:
- 10.1 Exchange Agreement, dated April 2, 2010, between Independent Bank Corporation and the United States Department of the Treasury (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed April 2, 2010).
 - 10.2 Form of waiver agreement executed by, among other employees, Michael M. Magee (President and Chief Executive Officer), William B. Kessel (Executive Vice President and Chief Operating Officer), Robert N. Shuster (Executive Vice President and Chief Financial Officer), David C. Reglin (Executive Vice President for Retail Banking), Stefanie M. Kimball (Executive Vice President and Chief Lending Officer) and Mark L. Collins (Executive Vice President and General Counsel) (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed April 16, 2010).
 - 10.3 Amendment to Technology Outsourcing Renewal Agreement, dated July 22, 2010, by and between Independent Bank Corporation and Metavante Corporation (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed July 27, 2010).
 - 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).

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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 August 6, 2010 By /s/ Robert N. Shuster
Robert N. Shuster, Principal Financial Officer

Date August 6, 2010 By /s/ James J. Twarozynski
James J. Twarozynski, Principal Accounting Officer