

INDEPENDENT BANK CORP /MI/  
Form 10-K  
March 10, 2011

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

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2010 or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-7818

INDEPENDENT BANK CORPORATION  
(Exact name of Registrant as specified in its charter)

MICHIGAN  
(State or other jurisdiction of incorporation)

38-2032782  
(I.R.S. employer identification no.)

230 W. Main St., P.O. Box 491, Ionia, Michigan  
(Address of principal executive offices)

48846  
(Zip Code)

Registrant's telephone number, including area code (616) 527-5820

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

Common Stock, \$1.00 Par Value  
(Title of class)  
8.25% Cumulative Trust Preferred Securities  
(Title of class)

NASDAQ  
(Name of Exchange)  
NASDAQ  
(Name of Exchange)

Securities registered pursuant to Section 12(g) of the Act: None.

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any,

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.

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

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

The aggregate market value of common stock held by non-affiliates of the Registrant as of June 30, 2010, was \$27,929,000.

The number of shares outstanding of the Registrant's common stock as of March 9, 2011 was 8,114,608.

Documents incorporated by reference

Portions of our definitive proxy statement, and annual report, to be delivered to shareholders in connection with the April 26, 2011 Annual Meeting of Shareholders are incorporated by reference into Part I, Part II, Part III, and Part IV of this Form 10-K.

The Exhibit Index appears on Pages 43-45

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## FORWARD-LOOKING STATEMENTS

Discussions and statements in this Annual Report on Form 10-K 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 2011; and descriptions of steps we may take to improve our capital position. 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;
  - further adverse developments in the vehicle service contract industry;
  - 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; and
- 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;

This list provides examples of factors that could affect the results described by forward-looking statements contained in this Annual Report on Form 10-K, but the list is not intended to be all inclusive. The risk factors disclosed in Part I – Item 1A below 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.



PART I

ITEM 1. BUSINESS

Independent Bank Corporation was incorporated under the laws of the State of Michigan on September 17, 1973, for the purpose of becoming a bank holding company. We are registered under the Bank Holding Company Act of 1956, as amended, and own the outstanding stock of Independent Bank (the "bank") which is organized under the laws of the State of Michigan. During 2007, we consolidated our existing four bank charters into one.

Aside from the stock of our bank, we have no other substantial assets. We conduct no business except for the collection of dividends from our bank and the payment of dividends to our shareholders. Certain employee retirement plans (including employee stock ownership and deferred compensation plans) as well as health and other insurance programs have been established by us. The costs of these plans are borne by our subsidiaries.

We have no material patents, trademarks, licenses or franchises except the corporate franchise of our bank which permits it to engage in commercial banking pursuant to Michigan law.

Our bank's main office location is Ionia, Michigan and it had total loans (excluding loans held for sale) and total deposits of \$1.813 billion and \$2.252 billion, respectively, at December 31, 2010.

Our bank transacts business in the single industry of commercial banking. Most of our bank's offices provide full-service lobby and drive-thru services in the communities they serve. Automatic teller machines are also provided at most locations.

Our bank's activities cover all phases of banking, including checking and savings accounts, commercial lending, direct and indirect consumer financing, mortgage lending and safe deposit box services. Mepco Finance Corporation, a subsidiary of our bank, acquires and services payment plans used by consumers to purchase vehicle service contracts provided and administered by third parties. In addition, our bank offers title insurance services through a separate subsidiary and provides investment and insurance services through a third party agreement with PrimeVest Financial Services, Inc. Our bank does not offer trust services. Our principal markets are the rural and suburban communities across Lower Michigan that are served by our bank's branch network. Our bank serves its markets through its main office and a total of 105 branches, 4 drive-thru facilities and 4 loan production offices. The ongoing economic stress in Michigan has adversely impacted many of our markets which is manifested in higher levels of loan defaults and lower demand for credit.

Our bank competes with other commercial banks, savings banks, credit unions, mortgage banking companies, securities brokerage companies, insurance companies, and money market mutual funds. Many of these competitors have substantially greater resources than we do and offer certain services that we do not currently provide. Such competitors may also have greater lending limits than our bank. In addition, non-bank competitors are generally not subject to the extensive regulations applicable to us.

Price (the interest charged on loans and/or paid on deposits) remains a principal means of competition within the financial services industry. Our bank also competes on the basis of service and convenience in providing financial services.

The principal sources of revenue, on a consolidated basis, are interest and fees on loans, other interest income and non-interest income. The sources of revenue for the three most recent years are as follows:

| 2010 | 2009 | 2008 |
|------|------|------|
|------|------|------|

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|                            |       |   |       |   |       |   |
|----------------------------|-------|---|-------|---|-------|---|
| Interest and fees on loans | 64.5  | % | 71.5  | % | 79.7  | % |
| Other interest income      | 3.0   |   | 4.5   |   | 7.3   |   |
| Non-interest income        | 32.5  |   | 24.0  |   | 13.0  |   |
|                            | 100.0 | % | 100.0 | % | 100.0 | % |

As of December 31, 2010, we had 982 full-time employees and 258 part-time employees.

## ITEM 1.

## BUSINESS (Continued)

## Recent Developments

Since 2009, we have been focused on strengthening our capital base in the face of weak economic conditions. Our bank began to experience rising levels of non-performing loans and higher provisions for loan losses in 2006 as the Michigan economy experienced economic stress ahead of national trends. Although our bank remained profitable through the second quarter of 2008, it began incurring losses in the third quarter of 2008, which losses pressured its capital ratios. While our bank has always remained well-capitalized under federal regulatory guidelines, we projected that due to our elevated levels of non-performing assets, as well as anticipated losses in the future, an increase in equity capital would likely be necessary in order for our bank to remain well-capitalized.

In 2009, we retained financial and legal advisors to assist us in reviewing our capital alternatives. We also took steps at that time to preserve our capital, including by discontinuing cash dividends on our common stock and exercising our right to defer all quarterly distributions on our outstanding trust preferred securities and the preferred stock we issued to the U.S. Department of the Treasury (the “Treasury”) pursuant to the Troubled Asset Relief Program (“TARP”). In December 2009, the Board of Directors of our bank adopted resolutions requiring our bank to achieve certain minimum capital ratios. The minimum ratios established by our bank's Board are higher than the minimum ratios necessary to be considered well-capitalized under federal regulatory standards, which we considered prudent given our elevated levels of non-performing assets and the continuing economic stress in Michigan. Set forth below are the minimum capital ratios imposed by our bank’s Board and the minimum ratios necessary to be considered well-capitalized under federal regulatory standards:

|  | Independent<br>Bank -<br>Actual as<br>of<br>December<br>31, 2010 |   | Minimum<br>Ratios<br>Established<br>by Our<br>Board |   | Required to be<br>Well-Capitalized |   |
|--|--|---|---|---|------------------------------------|---|
| Total Capital to Risk-Weighted Assets  | 11.06  | % | 11.00   | % | 10.00                              | % |
| Tier 1 Capital to Average Total Assets | 6.58   | % | 8.00  | % | 5.00                               | % |

In January 2010, our Board of Directors adopted a capital restoration plan (the “Capital Plan”) that documents our objectives and plans for meeting these ratios. The three primary initiatives of our Capital Plan are:

- the conversion of our 72,000 shares of Series A Fixed Rate Cumulative Perpetual Preferred Stock, with an original liquidation preference of \$1,000 per share (“Series A Preferred Stock”) issued to the Treasury under the Capital Purchase Program (“CPP”) of TARP into shares of our common stock;
  - an offer to exchange shares of our common stock for our outstanding trust preferred securities; and
  - a public offering of our common stock for cash.

In anticipation of pursuing these capital initiatives, we engaged independent third parties to perform a review (“stress test”) on our commercial and retail loan portfolios to confirm that the similar analyses we performed internally were reasonable and did not materially understate our projected loan losses. Based on the conclusions of these reviews, we determined that we did not need to modify our projections used for purposes of our Capital Plan.

To date, we have made progress on a number of initiatives to advance the Capital Plan:

- On January 29, 2010, we held a special shareholder meeting at which our shareholders approved (1) an increase in the number of shares of common stock we are authorized to issue from 60 million to 500 million, (2) the conversion of the preferred stock held by the Treasury into shares of our common stock, (3) the issuance of shares of our common stock in exchange for our outstanding trust preferred securities, and (4) an option exchange program pursuant to which our employees (excluding directors and certain executive officers) were able to exchange underwater options for new options at approximately a value-for-value exchange. This option exchange was completed in March 2010.
- On April 16, 2010, we closed an Exchange Agreement with the Treasury pursuant to which the Treasury exchanged \$72 million in aggregate liquidation value of our Series A Preferred Stock, plus approximately \$2.4 million in accrued but unpaid dividends on such shares, into 74,426 shares of our Series B Fixed Rate Cumulative Mandatorily Convertible Preferred Stock, with an original liquidation preference of \$1,000 per share (“Series B Convertible Preferred Stock”). As part of this exchange, we also amended and restated the terms of the Warrant issued to the Treasury in December 2008 to purchase 346,154 shares of our common stock



ITEM 1.

BUSINESS (Continued)

in order to adjust the initial exercise price of the Warrant to be equal to the conversion price applicable to the Series B Convertible Preferred Stock.

The shares of Series B Convertible Preferred Stock are convertible into shares of our common stock. Subject to the receipt of applicable approvals, the Treasury has the right to convert the Series B Convertible Preferred Stock into our common stock at any time. We have the right to compel a conversion of the Series B Convertible Preferred Stock into our common stock at any time provided the following conditions are met:

- (1) we receive appropriate approvals from the Board of Governors of the Federal Reserve System (the "Federal Reserve");
  - (2) at least \$40 million aggregate liquidation amount of our trust preferred securities are exchanged for shares of our common stock;
  - (3) we complete a new cash equity raise of not less than \$100 million on terms acceptable to the Treasury in its sole discretion (other than with respect to the price offered per share); and
  - (4) we make any required anti-dilution adjustments to the rate at which the Series B Convertible Preferred Stock is converted into our common stock.
- On June 23, 2010, we completed the exchange of an aggregate of 5,109,125 newly issued shares of our common stock for \$41.4 million in aggregate liquidation amount of our outstanding trust preferred securities and \$2.3 million of accrued and unpaid interest. This transaction satisfied one of the conditions to our ability to compel a conversion of the Series B Convertible Preferred Stock held by the Treasury.
  - On August 31, 2010, we effected a reverse stock split of our issued and outstanding common stock. Pursuant to this reverse split, each 10 shares of our common stock issued and outstanding immediately prior to the reverse split was converted into 1 share of our common stock. We conducted this reverse split primarily as a means to maintain our share price above \$1.00 per share in order to continue to meet Nasdaq listing standards. All share or per share information included in this Annual Report on Form 10-K has been retroactively restated to reflect the effects of the reverse split.

We have taken steps toward the advancement of the final phase of our Capital Plan, an offering of our common stock for cash, but have not commenced such offering. The offering has currently been delayed while we reevaluate our strategic alternatives in light of continued improvement in our asset quality and other recent positive indicators, as described in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of this Annual Report on Form 10-K. As of December 31, 2010, we met one of the two target capital ratios set forth in our Capital Plan as the bank's total capital to risk-weighted assets ratio of 11.06% exceeded the target of 11%.

In addition to the foregoing, we have taken steps to enhance our liquidity position in the face of current economic conditions by investing in shorter-term money market assets supported by higher-cost longer-term funding. This has negatively impacted our net interest margin during these periods. In addition, on July 7, 2010, we entered into an Investment Agreement with Dutchess Opportunity Fund, II, LP ("Dutchess") that establishes an equity line facility (the "Equity Line") as a contingent source of liquidity for the Company. Under the Investment Agreement, Dutchess committed to purchase, subject to certain conditions, up to \$15 million of our common stock over a 36-month period ending November 1, 2013. In connection with the Investment Agreement, we entered into a Registration Rights Agreement with Dutchess, pursuant to which we agreed to register for resale the shares that may be sold to Dutchess under the Equity Line. We filed a registration statement on Form S-1 with the SEC for the purpose of registering such shares for resale, and on November 1, 2010, the Securities and Exchange Commission ("SEC") declared such registration statement effective. During 2010, 0.3 million shares of our common stock were sold to Dutchess pursuant

to the Investment Agreement. In order to comply with Nasdaq rules, we would need shareholder approval to sell more than approximately 1.2 million more shares to Dutchess pursuant to the Investment Agreement. We intend to seek such shareholder approval at our 2011 annual shareholder meeting so that we have additional flexibility to take advantage of this contingent source of liquidity.

ITEM 1.

BUSINESS (Continued)

Supervision and Regulation

The following is a summary of certain statutes and regulations affecting us. This summary is qualified in its entirety by reference to the particular statutes and regulations. A change in applicable laws or regulations may have a material effect on us and our bank.

General

Financial institutions and their holding companies are extensively regulated under federal and state law. Consequently, our growth and earnings performance can be affected not only by management decisions and general and local economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. Those authorities include, but are not limited to, the Federal Reserve, the Federal Deposit Insurance Corporation (the "FDIC"), the Michigan Office of Financial and Insurance Regulation (the "OFIR"), the Internal Revenue Service, and state taxing authorities. The effect of such statutes, regulations and policies and any changes thereto can be significant and cannot necessarily be predicted.

Federal and state laws and regulations generally applicable to financial institutions and their holding companies regulate, among other things, the scope of business, investments, reserves against deposits, capital levels, lending activities and practices, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and dividends. The system of supervision and regulation applicable to us establishes a comprehensive framework for our operations and is intended primarily for the protection of the FDIC's deposit insurance funds, our depositors, and the public, rather than our shareholders.

Federal law and regulations establish supervisory standards applicable to the lending activities of our bank, including internal controls, credit underwriting, loan documentation and loan-to-value ratios for loans secured by real property.

Regulatory Developments

Emergency Economic Stabilization Act of 2008. On October 3, 2008, Congress enacted the Emergency Economic Stabilization Act of 2008 ("EESA"). The EESA enables the federal government, under terms and conditions developed by the Treasury, to insure troubled assets, including mortgage-backed securities, and collect premiums from participating financial institutions. The EESA includes, among other provisions: (a) the \$700 billion Troubled Assets Relief Program (TARP), under which the Treasury is authorized to purchase, insure, hold, and sell a wide variety of financial instruments, particularly those that are based on or related to residential or commercial mortgages originated or issued on or before March 14, 2008; and (b) an increase in the amount of deposit insurance provided by the FDIC. Both of these specific provisions are discussed below.

Troubled Assets Relief Program (TARP). Under TARP, the Treasury authorized a voluntary Capital Purchase Program (CPP) to purchase senior preferred shares of qualifying financial institutions that elected to participate. Participating companies must adopt certain standards for executive compensation, including (a) prohibiting "golden parachute" payments (as defined in the EESA) to senior executive officers; (b) requiring recovery of any compensation paid to senior executive officers based on criteria that is later proven to be materially inaccurate; and (c) prohibiting incentive compensation that encourages unnecessary and excessive risks that threaten the value of the financial institution. The terms of the CPP also limit certain uses of capital by the issuer, including repurchases of company stock and increases in dividends.

On December 12, 2008, we participated in the CPP and issued \$72 million in capital to the Treasury in the form of Series A Preferred Stock that paid cash dividends at the rate of 5% per annum through February 14, 2014, and 9% per annum thereafter. In addition, the Treasury received a Warrant to purchase 346,154 shares of our common stock at a price of \$31.20 per share. As described above, on April 16, 2010, we closed on an exchange transaction with the Treasury in which the Treasury accepted our newly issued shares of Series B Convertible Preferred Stock in exchange for the entire \$72 million in aggregate liquidation value of the shares of Series A Preferred Stock, plus the value of all accrued and unpaid dividends on such shares of Series A Preferred Stock (approximately \$2.4 million). The shares of Series B Convertible Preferred Stock have an aggregate liquidation amount equal to \$74,426,000.

ITEM 1.

BUSINESS (Continued)

With the exception of being convertible into shares of our common stock, the terms of the Series B Convertible Preferred Stock are substantially similar to the terms of the Series A Preferred Stock that were exchanged. The Series B Convertible Preferred Stock qualifies as Tier 1 regulatory capital, subject to limitations, and is entitled to cumulative dividends quarterly at a rate of 5% per annum through February 14, 2014, and 9% per annum thereafter. The Treasury (and any subsequent holder of the shares) has the right to convert the Series B Convertible Preferred Stock into our common stock at any time, subject to the receipt of any applicable approvals. We have the right to compel a conversion of the Series B Convertible Preferred Stock into our common stock if the following conditions are met:

- we receive appropriate approvals from the Federal Reserve;
- at least \$40 million aggregate liquidation amount of trust preferred securities have been exchanged for our common stock;
- we complete a new cash equity raise of not less than \$100 million on terms acceptable to the Treasury in its sole discretion (other than with respect to the price offered per share); and
- we make any required anti-dilution adjustments to the rate at which the Series B Convertible Preferred Stock is converted into our common stock.

If converted by the Treasury (or any subsequent holder) or by us pursuant to either of the above-described conversion rights, each share of Series B Convertible Preferred Stock (liquidation amount of \$1,000 per share) will convert into a number of shares of our common stock equal to a fraction, the numerator of which is \$750 and the denominator of which is \$7.234, referred to as the "conversion rate," provided that such conversion rate will be subject to certain anti-dilution adjustments. As an example only, at the time they were issued, the shares of Series B Convertible Preferred Stock were convertible into approximately 7.7 million shares of our common stock. This conversion rate will be subject to certain anti-dilution adjustments that may result in a greater number of shares being issued to the holder of the Series B Convertible Preferred Stock.

Unless earlier converted by the Treasury (or any subsequent holder) or by us as described above, the Series B Convertible Preferred Stock will convert into shares of our common stock on a mandatory basis on April 16, 2017. In any such mandatory conversion, each share of Series B Convertible 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 Convertible Preferred Stock).

At the time any shares of Series B Convertible Preferred Stock are converted into our common stock, we will be required to pay all accrued and unpaid dividends on the Series B Convertible 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 price of our common stock at the time of conversion (as such market price is determined pursuant to the terms of the Series B Convertible Preferred Stock). Accrued and unpaid dividends on the Series B Convertible Preferred Stock totaled approximately \$2.7 million at December 31, 2010.

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

In connection with such exchange transaction, we also amended and restated the terms of the Warrant issued to the Treasury in December 2008 to adjust the initial exercise price of the Warrant to be equal to the initial conversion price

applicable to the Series B Convertible Preferred Stock described above.

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ITEM 1.

BUSINESS (Continued)

Federal Deposit Insurance Coverage. The EESA temporarily raised the limit on federal deposit insurance coverage from \$100,000 to \$250,000 per depositor, and the Dodd-Frank Wall Street Reform and Consumer Protection Act passed in 2010 (the "Dodd-Frank Act") made this temporary increase in the insurance limit permanent. In October 2008, the FDIC also announced the Temporary Liquidity Guarantee Program. Under one component of this program, the Transaction Account Guarantee Program (TAGP), the FDIC temporarily provided unlimited coverage for non-interest bearing transaction accounts (as defined in the TAGP) for participating institutions that did not opt out. This temporary coverage expired on December 31, 2010; however, the Dodd-Frank Act extended protection similar to that provided under the TAGP through December 31, 2012.

Financial Stability Plan. On February 10, 2009, the Treasury announced the Financial Stability Plan ("FSP"), which is a comprehensive set of measures intended to shore up the U.S. financial system and earmarks the balance of the unused funds originally authorized under the EESA. The major elements of the FSP include: (i) a capital assistance program that will invest in convertible preferred stock of certain qualifying institutions, (ii) a consumer and business lending initiative to fund new consumer loans, small business loans and commercial mortgage asset-backed securities issuances, (iii) a new public-private investment fund that will leverage public and private capital with public financing to purchase up to \$500 billion to \$1 trillion of legacy "toxic assets" from financial institutions, and (iv) assistance for homeowners by providing up to \$75 billion to reduce mortgage payments and interest rates and establishing loan modification guidelines for government and private programs.

American Recovery and Reinvestment Act of 2009. On February 17, 2009, Congress enacted the American Recovery and Reinvestment Act of 2009 ("ARRA"). In enacting the ARRA, Congress intended to provide a stimulus to the U.S. economy in light of the significant economic downturn. The ARRA includes federal tax cuts, expansion of unemployment benefits and other social welfare provisions, and numerous domestic spending efforts in education, healthcare and infrastructure. The ARRA also includes numerous non-economic recovery related items, including a limitation on executive compensation in federally-aided financial institutions, including banks that have received or will receive assistance under TARP.

Under the ARRA, a financial institution (including our bank) will be subject to the following restrictions and standards throughout the period in which any obligation arising from financial assistance provided under TARP remains outstanding:

- Limits on compensation incentives for risk-taking by senior executive officers;
- Requirement of recovery of any compensation paid based on inaccurate financial information;
  - Prohibition on "golden parachute payments" (as defined in the AARA);
- Prohibition on compensation plans that would encourage manipulation of reported earnings to enhance the compensation of employees;
- Establishment of board compensation committees by publicly-registered TARP recipients comprised entirely of independent directors, for the purpose of reviewing employee compensation plans;
- Prohibition on bonuses, retention awards, and incentive compensation, except for payments of long-term restricted stock; and
  - Limitation on luxury expenditures.

In addition, TARP recipients are required to permit a separate, non-binding shareholder vote to approve the compensation of executives. The chief executive officer and chief financial officer of each TARP recipient will be required to provide a written certification of compliance with these standards to the SEC.





ITEM 1.

BUSINESS (Continued)

Homeowner Affordability and Stability Plan. On February 18, 2009, President Obama announced the Homeowner Affordability and Stability Plan ("HASP"). The HASP is intended to support a recovery in the housing market and ensure that workers can continue to pay off their mortgages through the following elements:

- Provide access to low-cost refinancing for responsible homeowners suffering from falling home prices;
- A \$75 billion homeowner stability initiative to prevent foreclosure and help responsible families stay in their homes; and
  - Support of low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac.

The Treasury has issued extensive guidance on the scope and mechanics of various components of HASP. We continue to monitor these developments and assess their potential impact on our business.

Dodd-Frank Act. On July 21, 2010, the President signed the Dodd-Frank Act in law. This new federal law includes the following:

- the creation of a new Consumer Financial Protection Bureau with power to promulgate and, with respect to financial institutions with more than \$10 billion in assets, 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 to the U.S. economy;
- provisions affecting corporate governance and executive compensation of all companies whose securities are registered with the SEC;
- a provision that will broaden the base for FDIC insurance assessments and permanently increase FDIC deposit insurance to \$250,000;
- a provision under which interchange fees for debit cards of issuers with at least \$10 billion in assets will be set by the Federal Reserve under a restrictive "reasonable and proportional cost" per transaction standard;
- a provision that will require bank regulators to set minimum capital levels for bank holding companies that are at least as strong as those required for their insured depository subsidiaries, subject to a grandfather clause for financial institutions with less than \$15 billion in assets as of December 31, 2009; and
  - new restrictions on how mortgage brokers and loan originators may be compensated.

When implemented, these provisions 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 are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on us, our customers or the financial industry more generally.

Future Legislation. Various other legislative and regulatory initiatives, including proposals to overhaul the banking regulatory system, are from time to time introduced in Congress and state legislatures, as well as regulatory agencies. Such future legislation regarding financial institutions may change banking statutes and our operating environment in substantial and unpredictable ways, and could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance depending on whether any such potential legislation is introduced and enacted. The nature and extent of future legislative and regulatory changes affecting financial institutions is very unpredictable. We cannot determine the ultimate effect that any such potential legislation, if enacted, would have upon our financial condition or results of operations.

Independent Bank Corporation

We are a bank holding company and, as such, are registered with, and subject to regulation by, the Federal Reserve under the Bank Holding Company Act, as amended (the "BHCA"). Under the BHCA, we are subject to periodic examination by the Federal Reserve and are required to file periodic reports of operations and such additional information as the Federal Reserve may require.

ITEM 1.

BUSINESS (Continued)

Federal Reserve policy historically has required bank holding companies to act as a source of strength to their bank subsidiaries and to commit capital and financial resources to support those subsidiaries. The Dodd-Frank Act codified this policy as a statutory requirement. Such support may be required by the Federal Reserve at times when we might otherwise determine not to provide it.

In addition, if the OFIR deems a bank's capital to be impaired, the OFIR may require a bank to restore its capital by special assessment upon a bank holding company, as the bank's sole shareholder. If the bank holding company failed to pay such assessment, the directors of that bank would be required, under Michigan law, to sell the shares of bank stock owned by the bank holding company to the highest bidder at either public or private auction and use the proceeds of the sale to restore the bank's capital.

Any capital loans by a bank holding company to a subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Investments and Activities. In general, any direct or indirect acquisition by a bank holding company of any voting shares of any bank which would result in the bank holding company's direct or indirect ownership or control of more than 5% of any class of voting shares of such bank, and any merger or consolidation of the bank holding company with another bank holding company, will require the prior written approval of the Federal Reserve under the BHCA. In acting on such applications, the Federal Reserve must consider various statutory factors including the effect of the proposed transaction on competition in relevant geographic and product markets, and each party's financial condition, managerial resources, and record of performance under the Community Reinvestment Act.

In addition and subject to certain exceptions, the Change in the Bank Control Act ("Control Act") and regulations promulgated thereunder by the Federal Reserve, require any person acting directly or indirectly, or through or in concert with one or more persons, to give the Federal Reserve 60 days' written notice before acquiring control of a bank holding company. Transactions which are presumed to constitute the acquisition of control include the acquisition of any voting securities of a bank holding company having securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, if, after the transaction, the acquiring person (or persons acting in concert) owns, controls or holds with power to vote 10% or more of any class of voting securities of the institution. The acquisition may not be consummated subsequent to such notice if the Federal Reserve issues a notice within 60 days, or within certain extensions of such period, disapproving the acquisition.

The merger or consolidation of an existing bank subsidiary of a bank holding company with another bank, or the acquisition by such a subsidiary of the assets of another bank, or the assumption of the deposit and other liabilities by such a subsidiary requires the prior written approval of the responsible Federal depository institution regulatory agency under the Bank Merger Act, based upon a consideration of statutory factors similar to those outlined above with respect to the BHCA. In addition, in certain cases an application to, and the prior approval of, the Federal Reserve under the BHCA and/or OFIR under Michigan banking laws, may be required.

With certain limited exceptions, the BHCA prohibits any bank holding company from engaging, either directly or indirectly through a subsidiary, in any activity other than managing or controlling banks unless the proposed non-banking activity is one that the Federal Reserve has determined to be so closely related to banking as to be a proper incident thereto. Under current Federal Reserve regulations, such permissible non-banking activities include such things as mortgage banking, equipment leasing, securities brokerage, and consumer and commercial finance company operations. Well-capitalized and well-managed bank holding companies may, however, engage de novo in

certain types of non-banking activities without prior notice to, or approval of, the Federal Reserve, provided that written notice of the new activity is given to the Federal Reserve within 10 business days after the activity is commenced. If a bank holding company wishes to engage in a non-banking activity by acquiring a going concern, prior notice and/or prior approval will be required, depending upon the activities in which the company to be acquired is engaged, the size of the company to be acquired and the financial and managerial condition of the acquiring bank holding company.

ITEM 1.

BUSINESS (Continued)

Eligible bank holding companies that elect to operate as financial holding companies may engage in, or own shares in companies engaged in, a wider range of nonbanking activities, including securities and insurance activities and any other activity that the Federal Reserve, in consultation with the Treasury, determines by regulation or order is financial in nature, incidental to any such financial activity or complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. The BHCA generally does not place territorial restrictions on the domestic activities of non-bank subsidiaries of bank or financial holding companies. We have not applied for approval to operate as a financial holding company and have no current intention of doing so.

**Capital Requirements.** The Federal Reserve uses capital adequacy guidelines in its examination and regulation of bank holding companies. If capital falls below minimum guidelines, a bank holding company may, among other things, be denied approval to acquire or establish additional banks or non-bank businesses.

The Federal Reserve's capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: (i) a leverage capital requirement expressed as a percentage of total assets, and (ii) a risk-based requirement expressed as a percentage of total risk-weighted assets. The leverage capital requirement consists of a minimum ratio of Tier 1 capital (which consists principally of shareholders' equity) to total assets of 3% for the most highly rated companies with minimum requirements of 4% to 5% for all others. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, of which at least one-half must be Tier 1 capital.

The risk-based and leverage standards presently used by the Federal Reserve are minimum requirements, and higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations.

Included in our Tier 1 capital as of December 31, 2010, is \$44.1 million of trust preferred securities (classified on our balance sheet as "Subordinated debentures"). The Federal Reserve 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 could be included in the Tier 2 capital, subject to restrictions. The provisions of the Dodd-Frank Act imposed additional limitations on the ability to include trust preferred securities as Tier 1 capital; however, these additional limitations do not apply to our outstanding trust preferred securities.

The federal bank regulatory agencies are required biennially to review risk-based capital standards to ensure that they adequately address interest rate risk, concentration of credit risk and risks from non-traditional activities.

**Dividends.** Most of our revenues are received in the form of dividends paid by our bank. Thus, our ability to pay dividends to our shareholders is indirectly limited by statutory restrictions on the ability of our bank to pay dividends, as discussed below. Further, in a policy statement, the Federal Reserve has expressed its view that a bank holding company experiencing earnings weaknesses should not pay cash dividends exceeding its net income or which can only be funded in ways that weaken the bank holding company's financial health, such as by borrowing. Additionally, the Federal Reserve possesses enforcement powers over bank holding companies and their non-bank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies. The "prompt corrective action" provisions of federal law and regulation authorizes the Federal Reserve to restrict the amount of dividends that an insured bank can pay which fails to meet specified capital levels.

In addition to the restrictions on dividends imposed by the Federal Reserve, the Michigan Business Corporation Act provides that dividends may be legally declared or paid only if after the distribution, a corporation can pay its debts as they come due in the usual course of business and its total assets equal or exceed the sum of its liabilities plus the amount that would be needed to satisfy the preferential rights upon dissolution of any holders of preferred stock whose preferential rights are superior to those receiving the distribution.

## ITEM 1.

## BUSINESS (Continued)

Finally, dividends on our common stock must be paid in accordance with the terms and restrictions of the CPP and our Exchange Agreement with the Treasury. Prior to December 12, 2011, unless we have redeemed all of the shares of the Series B Convertible Preferred Stock or unless the Treasury ceases to own any of our debt or equity securities acquired pursuant to the Exchange Agreement or the amended and restated Warrant, the consent of the Treasury will be required for us to declare or pay any dividend or make any distribution on or repurchase of common stock other than (i) regular quarterly cash dividends of not more than \$0.10 per share, as adjusted for any stock split, stock dividend, reverse stock split, reclassification or similar transaction, (ii) dividends payable solely in shares of our common stock, and (iii) dividends or distributions of rights or junior stock in connection with any shareholders' rights plan. Notwithstanding the foregoing, because we have suspended all dividends on the shares of the Series B Convertible Preferred Stock and all quarterly payments on our outstanding trust preferred securities, we are currently prohibited from paying any cash dividends on our common stock. In addition, in December of 2009, our Board of Directors adopted resolutions that prohibit us from paying any dividends on our common stock without, in each case, the prior written approval of the Federal Reserve and the OFIR.

**Federal Securities Regulation.** Our common stock is registered with the SEC under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We are therefore subject to the information, proxy solicitation, insider trading and other restrictions and requirements of the SEC under the Exchange Act.

**Our Bank**

**General.** Independent Bank is a Michigan banking corporation, is a member of the Federal Reserve System, and its deposit accounts are insured by the Deposit Insurance Fund ("DIF") of the FDIC. As a member of the Federal Reserve System and a Michigan chartered bank, our bank is subject to the examination, supervision, reporting and enforcement requirements of the Federal Reserve as its primary federal regulator and OFIR as the chartering authority for Michigan banks. These agencies and the federal and state laws applicable to our bank and its operations extensively regulate various aspects of the banking business including, among other things, permissible types and amounts of loans, investments and other activities, capital adequacy, branching, interest rates on loans and on deposits, the maintenance of non-interest bearing reserves on deposit accounts, and the safety and soundness of banking practices.

**Deposit Insurance.** As an FDIC-insured institution, our bank is required to pay deposit insurance premium assessments to the FDIC. Under the FDIC's risk-based assessment system for deposit insurance premiums, all insured depository institutions are placed into one of four categories (Risk Categories I, II, III, and IV), based primarily on their level of capital and supervisory evaluations.

Historically, assessment rates for deposit insurance premiums have been largely based on the risk category of the institution and the amount of its deposits. However, the Dodd-Frank Act passed in 2010 required the FDIC to establish rules setting insurance premium assessments based on an institution's total assets minus its tangible equity instead of deposits. On February 7, 2011, the FDIC adopted a final rule under which, effective for assessments for the second quarter of 2011 and payable at the end of September 2011, the initial base assessment rate for institutions in Risk Category I (generally, well-capitalized institutions with a CAMELS composite rating of 1 or 2) is set at an annual rate of between 5 and 9 basis points. The initial base assessment rate for institutions in Risk Categories II, III, and IV is set at annual rates of 14, 23, and 35 basis points, respectively, and the initial base assessment rate for institutions with at least \$10 billion in assets and certain "highly complex institutions" is set at an annual rate of between 5 and 35 basis points. These initial base assessment rates are adjusted to determine an institution's final assessment rate based on its brokered deposits and unsecured debt. In addition, the rates are subject to a new

depository institution debt adjustment, which is meant to offset the benefit received by institutions that issue long-term, unsecured liabilities when those liabilities are held by other insured depository institutions. However, institutions may exclude from the unsecured debt amount used in calculating the depository institution debt adjustment an amount equal to no more than 3% of their Tier 1 capital. Total base assessment rates after adjustments, other than the depository institution debt adjustment, range from 2.5 to 9 basis points for Risk Category I, 9 to 24 basis points for Risk Category II, 18 to 33 basis points for Risk Category III, 30 to 45 basis points for Risk Category IV, and 2.5 to 45 basis points for institutions with at least \$10 billion in assets and certain "highly complex institutions."



## ITEM 1.

## BUSINESS (Continued)

On December 15, 2010, the FDIC established 2.0% as the Designated Reserve Ratio ("DRR"), that is, the ratio of the DIF to insured deposits. The FDIC adopted a plan under which it will meet the statutory minimum DRR of 1.35% by September 30, 2020, the deadline imposed by the Dodd-Frank Act. The Dodd-Frank Act requires the FDIC to partially offset the effect of the increase in the DRR on institutions with assets less than \$10 billion.

During the fourth quarter of 2009, we prepaid 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 \$15.9 million at December 31, 2010 and will be expensed over the assessment period (through the fourth quarter of 2012). The actual expense over the assessment periods will be different from this prepaid amount due to various factors, including variances in actual deposit balances and the assessment base and rates used during each assessment period.

In addition, in 2008, the bank elected to participate in the FDIC's Transaction Account Guarantee Program (TAGP), which required us to pay an additional assessment to the FDIC. Under the TAGP, funds in non-interest bearing transaction accounts, in interest-bearing transaction accounts with an interest rate of 0.25% or less (after June 30, 2010), and in Interest on Lawyers Trust Accounts (IOLTA) had a temporary unlimited guarantee from the FDIC. This temporary coverage expired on December 31, 2010. The Dodd-Frank Act extended protection similar to that provided under the TAGP through December 31, 2012 for only non-interest bearing transaction accounts. This coverage applies to all insured depository institutions, and there is no separate FDIC assessment for the insurance. Furthermore, this unlimited coverage is separate from, and in addition to, the coverage provided to depositors with respect to other accounts held at an insured depository institution.

**FICO Assessments.** Our bank, as a member of the DIF, is subject to assessments to cover the payments on outstanding obligations of the Financing Corporation ("FICO"). FICO was created to finance the recapitalization of the Federal Savings and Loan Insurance Corporation, the predecessor to the FDIC's Savings Association Insurance Fund which was created to insure the deposits of thrift institutions and was merged with the Bank Insurance Fund into the newly formed DIF in 2006. From now until the maturity of the outstanding FICO obligations in 2019, DIF members will share the cost of the interest on the FICO bonds on a pro rata basis. It is estimated that FICO assessments during this period will be approximately 0.010% of deposits.

**OFIR Assessments.** Michigan banks are required to pay supervisory fees to the OFIR to fund their operations. The amount of supervisory fees paid by a bank is based upon the bank's total assets.

**Capital Requirements.** The Federal Reserve has established the following minimum capital standards for state-chartered, FDIC-insured member banks, such as our bank: a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with minimum requirements of 4% to 5% for all others, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. Tier 1 capital consists principally of shareholders' equity. These capital requirements are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, Federal Reserve regulations provide that higher capital may be required to take adequate account of, among other things, interest rate risk and the risks posed by concentrations of credit, nontraditional activities, or securities trading activities.

## ITEM 1.

## BUSINESS (Continued)

Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized." Federal regulations define these capital categories as follows:

|                                   | Total<br>Risk-Based<br>Capital Ratio | Tier 1<br>Risk-Based<br>Capital Ratio | Leverage Ratio  |
|-----------------------------------|--------------------------------------|---------------------------------------|---|
| Well capitalized                  | 10% or above                         | 6% or above                           | 5% or above   |
| Adequately capitalized            | 8% or above                          | 4% or above                           | 4% or above   |
| Undercapitalized                  | Less than 8%                         | Less than 4%                          | Less than 4%  |
| Significantly<br>undercapitalized | Less than 6%                         | Less than 3%                          | Less than 3%  |
| Critically<br>undercapitalized    | --                                   | --                                    | A ratio of tangible equity to<br>total assets of 2% or less |

At December 31, 2010, our bank's ratios exceeded minimum requirements for the well-capitalized category. In December 2009, the Board of Directors of our bank adopted resolutions requiring our bank to achieve minimum capital ratios that are higher than the minimum requirements described in the Federal Reserve's capital guidelines. See "Recent Developments" above for more information.

Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the interest rates the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and ultimately, appointing a receiver for the institution.

In general, a depository institution may be reclassified to a lower category than is indicated by its capital levels if the appropriate federal depository institution regulatory agency determines the institution to be otherwise in an unsafe or unsound condition or to be engaged in an unsafe or unsound practice. This could include a failure by the institution, following receipt of a less-than-satisfactory rating on its most recent examination report, to correct the deficiency.

**Dividends.** Under Michigan law, banks are restricted as to the maximum amount of dividends they may pay on their common stock. Our bank may not pay dividends except out of its net income after deducting its losses and bad debts. A Michigan state bank may not declare or pay a dividend unless the bank will have a surplus amounting to at least 20% of its capital after the payment of the dividend.

As a member of the Federal Reserve System, our bank is required to obtain the prior approval of the Federal Reserve for the declaration or payment of a dividend if the total of all dividends declared in any year will exceed the total of (a) the bank's retained net income (as defined by federal regulation) for that year, plus (b) the bank's retained net income for the preceding two years.

Federal law also generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. In addition, the Federal Reserve may prohibit the payment of dividends by a bank if such payment is determined, by reason of the financial condition of the bank, to be an unsafe and unsound banking practice or if the bank is in default of payment of any assessment due to the FDIC.

In addition to these restrictions, in December of 2009, the Board of Directors of our bank adopted resolutions that prohibit our bank from paying any dividends to our holding company without the prior written approval of the Federal Reserve and the OFIR. See "Recent Developments" above for more information.

ITEM 1.

BUSINESS (Continued)

**Insider Transactions.** Our bank is subject to certain restrictions imposed by the Federal Reserve Act on "covered transactions" with us or our subsidiaries, which include investments in our stock or other securities issued by us or our subsidiaries, the acceptance of our stock or other securities issued by us or our subsidiaries as collateral for loans, and extensions of credit to us or our subsidiaries. Certain limitations and reporting requirements are also placed on extensions of credit by our bank to the directors and officers of the Company, the bank, and the subsidiaries of the bank, to the principal shareholders of the Company, and to "related interests" of such directors, officers, and principal shareholders. In addition, federal law and regulations may affect the terms upon which any person becoming one of our directors or officers or a principal shareholder may obtain credit from banks with which our bank maintains a correspondent relationship.

**Safety and Soundness Standards.** Pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), the FDIC adopted guidelines to establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines establish standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality, and earnings.

**Investment and Other Activities.** Under federal law and regulations, FDIC-insured state banks are prohibited, subject to certain exceptions, from making or retaining equity investments of a type, or in an amount, that are not permissible for a national bank. FDICIA, as implemented by FDIC regulations, also prohibits FDIC-insured state banks and their subsidiaries, subject to certain exceptions, from engaging as a principal in any activity that is not permitted for a national bank or its subsidiary, respectively, unless the bank meets, and continues to meet, its minimum regulatory capital requirements and the bank's primary federal regulator determines the activity would not pose a significant risk to the DIF. Impermissible investments and activities must be otherwise divested or discontinued within certain time frames set by the bank's primary federal regulator in accordance with federal law. These restrictions are not currently expected to have a material impact on the operations of our bank.

**Consumer Banking.** Our bank's business includes making a variety of types of loans to individuals. In making these loans, our bank is subject to state usury and regulatory laws and to various federal statutes, including the privacy of consumer financial information provisions of the Gramm Leach-Bliley Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, and the regulations promulgated under these statutes, which (among other things) prohibit discrimination, specify disclosures to be made to borrowers regarding credit and settlement costs, and regulate the mortgage loan servicing activities of our bank, including the maintenance and operation of escrow accounts and the transfer of mortgage loan servicing. In receiving deposits, our bank is subject to extensive regulation under state and federal law and regulations, including the Truth in Savings Act, the Expedited Funds Availability Act, the Bank Secrecy Act, the Electronic Funds Transfer Act, and the Federal Deposit Insurance Act. Violation of these laws could result in the imposition of significant damages and fines upon our bank and its directors and officers.

**Branching Authority.** Michigan banks, such as our bank, have the authority under Michigan law to establish branches anywhere in the State of Michigan, subject to receipt of all required regulatory approvals. Banks may establish interstate branch networks through acquisitions of other banks. The establishment of de novo interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is allowed only if specifically authorized by state law.

Michigan permits both U.S. and non-U.S. banks to establish branch offices in Michigan. The Michigan Banking Code permits, in appropriate circumstances and with the approval of the OFIR (1) acquisition of Michigan banks by FDIC-insured banks or savings banks located in other states, (2) sale by a Michigan bank of branches to an

FDIC-insured bank or savings bank located in a state in which a Michigan bank could purchase branches of the purchasing entity, (3) consolidation of Michigan banks and FDIC-insured banks or savings banks located in other states having laws permitting such consolidation, (4) establishment of branches in Michigan by FDIC-insured banks located in other states, the District of Columbia or U.S. territories or protectorates having laws permitting a Michigan bank to establish a branch in such jurisdiction, and (5) establishment by foreign banks of branches located in Michigan.

ITEM 1.

BUSINESS (Continued)

Mepco Finance Corporation

Our subsidiary, Mepco Finance Corporation, is engaged in the business of acquiring and servicing payment plans used by consumers throughout the United States who have purchased a vehicle service contract and choose to make monthly payments for their coverage. In the typical transaction, no interest or other finance charge is charged to these consumers. As a result, Mepco is generally not subject to regulation under consumer lending laws. However, Mepco is subject to various federal and state laws designed to protect consumers, including laws against unfair and deceptive trade practices and laws regulating Mepco's payment processing activities, such as the Electronic Funds Transfer Act.

Mepco purchases payment plans from companies (which we refer to as Mepco's "counterparties") that provide vehicle service contracts 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 or charges in vehicle service contract contingencies expense, included in non-interest expenses, for estimated defaults by these counterparties in their obligations to Mepco.

Our annual reports on Forms 10-K, quarterly reports on Forms 10-Q, current reports on Forms 8-K, and all amendments to those reports are available free of charge through our website at [www.IndependentBank.com](http://www.IndependentBank.com) as soon as reasonably practicable after filing with the SEC.

ITEM 1. BUSINESS -- STATISTICAL DISCLOSURE  
 I. (A) DISTRIBUTION OF ASSETS, LIABILITIES AND STOCKHOLDERS' EQUITY;  
 (B) INTEREST RATES AND INTEREST DIFFERENTIAL  
 (C) INTEREST RATES AND DIFFERENTIAL

The information set forth in the tables captioned "Average Balances and Rates" and "Change in Net Interest Income" of our annual report, to be delivered to shareholders in connection with the April 26, 2011 Annual Meeting of Shareholders (filed as exhibit 13 to this report on Form 10-K), is incorporated herein by reference.

II. INVESTMENT PORTFOLIO

(A) The following table sets forth the book value of securities at December 31:

|   | 2010     | 2009           | 2008      |
|---|----------|----------------|-----------|
|   |          | (in thousands) |           |
| Trading - Preferred stock                 | \$32     | \$54           | \$1,929   |
| Available for sale                        |          |                |           |
| States and political subdivisions         | \$31,259 | \$67,132       | \$105,553 |
| U.S agency residential mortgage-backed    | 13,331   | 47,522         | 48,029    |
| Private label residential mortgage-backed | 14,184   | 30,975         | 36,887    |
| Trust preferred                           | 9,090    | 13,017         | 12,706    |
| Other asset-backed                        | --       | 5,505          | 7,421     |
| Preferred stock                           | --       | --             | 4,816     |
| Total                                     | \$67,864 | \$164,151      | \$215,412 |

(B) The following table sets forth contractual maturities of securities at December 31, 2010 and the weighted average yield of such securities:

|  | Maturing<br>Within<br>One Year |       | Maturing<br>After One<br>But Within<br>Five Years |       | Maturing<br>After Five<br>But Within<br>Ten Years |       | Maturing<br>After<br>Ten Years |        |
|--|--------------------------------|-------|---|-------|---|-------|--------------------------------|--------|
|  | Amount                         | Yield | Amount  | Yield | Amount  | Yield | Amount                         | Yield  |
| Trading – Preferred stock                              |                                |       |   |       |   |       | \$ 32                          | 0.00 % |
| Tax equivalent adjustment<br>for calculations of yield |                                |       |   |       |   |       | \$ --                          |        |