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2010 Annual Report

BNCCORP, INC.

BNCCORP, INC. (BNCCORP or the Company) is a bank holding company registered under the Bank Holding Company Act of 1956 headquartered in Bismarck, North Dakota. It is the parent company of BNC National Bank (the Bank). The Company operates community banking and wealth management businesses in Arizona, Minnesota and North Dakota from 18 locations. BNC also conducts mortgage banking from 10 locations in Arizona, Minnesota, Iowa, Kansas, Nebraska and Missouri.

GREGORY K. CLEVELAND
President and Chief Executive Officer

"As we entered 2011 the overall economic environment showed tentative signs of stabilization after several years of turbulence."

To Our Stockholders, Customers, Employees and Friends:

As we entered 2011 the overall economic environment showed tentative signs of stabilization after several years of turbulence. That said, a robust recovery is not yet in evidence. Unemployment continues to be stubbornly high. Many corporations remain reluctant to invest and are choosing to hold record levels of cash. Consumer spending is cautious and the housing market remains problematic.

At the same time, global conditions have dramatically altered the landscape for businesses and governments. In response to world-wide economic uncertainties, legislative and regulatory authorities have unleashed a flood of new regulations that will have a significant impact on financial institutions. While it is certain these new regulations will be burdensome, our industry and consumers of financial products are not likely to fully comprehend the full impact of the new regulatory environment for quite some time.

Throughout this challenging period, our approach at BNC has been to focus sharply on addressing credit issues, maintaining liquidity and managing capital. For example, we reduced nonperforming assets by almost one-third in the past year and our yearend cash balances exceed $100 million. Clearly, this focus has served us well and continues to provide relative stability at a time when economic outlook remains uncertain.

Improving Credit Quality

BNC has taken prudent and appropriate actions to deal with the elevated levels of nonperforming assets that we, and many financial institutions, faced as a result of the recession. We have benefited from our ongoing and rigorous scrutiny of asset quality, as well as our decision in 2009 to increase the provision for loan losses.

Our credit quality trends improved in 2010, as reflected in the significant decreases in nonperforming assets (which decreased by $12.6 million, or 29%) and nonperforming loans (which decreased by $18.0 million, or 50%). Our provisions for credit losses and other real estate costs also declined significantly in 2010 while the allowance for credit losses as a percentage of loans and leases held for investment improved.

Strengthening Our Capital Foundation

In November 2010, we entered into an agreement to sell certain loans and deposits in our Arizona and Minnesota markets to another banking institution. This transaction positions BNC for the future by enhancing the Bank's capital ratios; we project our leverage ratio will be approximately 9% and our total risk based ratio will be approximately 15%.

It is important to note that we will continue to offer a full range of banking and mortgage banking services in our Arizona and Minnesota communities following the sale. Equally important, if not more importantly, the transaction also does not impact our operations in North Dakota. We look forward to participating in growth opportunities in all our markets, particularly North Dakota – where we are committed to expanding our resources and growing our presence.

Responding to a Challenge

In May 2010, we reported that the Company had discovered fraudulent activity by an external company that was servicing residential mortgage loans for BNC. Since that time we have been diligently addressing this matter. We commenced investigations, which have confirmed that the fraudulent activity was limited to the external servicing company and that no bank employees were involved in this wrongful conduct by the servicing company. In the second quarter, we determined the scope of the fraud losses and recorded a loss. Since then, we have filed a legal claim against our insurance carriers and we firmly believe our claim is strong. This matter is discussed in further detail in Note 4 of our Consolidated Financial Statements.

Our people responded to this challenge with incredible resolve. As a result, there has been limited impact on our day-to-day business or on our capacity to deliver superior service to our customers.

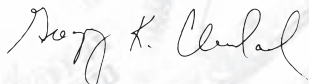
2011 Outlook

We continue to believe that the operating and regulatory environment will remain unsettled for the foreseeable future. While some regions are showing economic vitality – including our own North Dakota market – this is more the exception than the rule.

Therefore, we are convinced that our strategy which hones in on credit quality, liquidity and capital remains right for the times. We will continue to focus on reducing nonperforming assets where possible and maintaining reserves when necessary. We will manage our investment portfolio to ensure that the Company has sufficient liquidity. And we will manage our capital to support our business. At the same time, we will continue to deliver the attentive customer service that is a tradition at BNC – and a significant competitive advantage in a changing financial marketplace.

Our ability to address the challenges of recent years is a reflection of the dedication of our employees, the loyalty of our customers and shareholders, and the sound guidance of our Board of Directors. I thank all of you for your support and look forward to building BNC in the future.

Sincerely,



GREGORY K. CLEVELAND
President and Chief Executive Officer

BNCCORP, INC.

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December 31, 2010

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Selected Financial Data

The selected consolidated financial data presented below should be read in conjunction with our audited financial statements and the notes thereto (dollars in thousands, except share and per share data):

	For the Years Ended December 31,				
	2010	2009	2008	2007[1]	2006
Income Statement Data from Continuing Operations:					
Total interest income	$ 33,510	$ 44,588	$ 46,026	$ 44,241	$ 42,408
Total interest expense	10,238	14,899	19,215	21,994	23,606
Net interest income	23,272	29,689	26,811	22,247	18,802
Provision for credit losses	5,750	27,000	7,750	3,750	210
Non-interest income	23,973	16,013	10,395	3,853	5,138
Fraud loss on assets serviced by others	26,231	-	-	-	-
Non-interest expense, excluding fraud loss on assets serviced by others	37,257	39,103	26,501	28,147	23,075
Income tax expense (benefit)	72	(1,625)	737	(2,728)	(363)
Income (loss) from continuing operations	$ (22,065)	$ (18,776)	$ 2,218	$ (3,069)[1]	$ 1,018
Balance Sheet Data: (at end of period)					
Total assets	$ 747,069	$ 868,083	$ 861,498	$ 699,591	$ 692,276
Investments securities available for sale	137,032	212,661	209,857	122,899	182,974
Federal Funds Sold	-	-	-	-	24,000
Federal Reserve Bank and Federal Home Loan Bank stock	2,862	3,048	5,989	4,918	5,003
Loans held for sale-mortgage banking	29,116	24,130	13,403	-	1,669
Participating interests in mortgage loans	4,888	38,534	28,584	24,357	56,125
Loans and leases held for investment, net of unearned income	350,501	517,108	542,753	497,556	333,934
Other loans held for sale, net	70,501	-	-	-	-
Allowance for credit losses[2]	(16,476)	(18,047)	(8,751)	(6,599)	(3,370)
Allowance for credit losses[3]	(14,765)	-	-	-	-
Total deposits[2]	661,111	755,963	675,321	541,874	529,252
Core deposits[2]	594,152	640,169	575,637	541,874	529,054
Short-term borrowings	16,329	10,190	16,844	5,365	9,709
Federal Home Loan Bank advances	-	15,000	84,500	61,400	62,200
Other borrowings	-	-	-	-	1,167
Guaranteed preferred beneficial interests in Company's subordinated debentures	24,134	22,890	23,025	23,075	22,711
Common stockholders' equity	16,835	36,980	53,947	59,730	55,602
Book value per common share outstanding	$ 5.09	$ 11.24	$ 16.35	$ 17.11	$ 15.44
Tangible book value	$ 5.09	$ 11.24	$ 16.23	$ 16.99	$ 7.15
Earnings Performance / Share Data from Continuing Operations:					
Return (loss) on average total assets	(2.79)%	(2.09)%	0.28%	(0.47)%	0.14%
Return (loss) on average common stockholders' equity	(90.47)%	(38.88)%	3.85%	(5.25)%	1.92%
Efficiency ratio	134.38%	85.56%	71.22%	107.85%	96.39%
Net interest margin	3.20%	3.58%	3.64%	3.81%	3.04%
Net interest spread	3.14%	3.37%	3.46%	3.31%	2.73%
Basic earnings (loss) per common share	$ (7.13)	$ (6.14)	$ 0.67	$ (0.89)	$ 0.29
Diluted earnings (loss) per common share	$ (7.13)	$ (6.14)	$ 0.67	$ (0.89)	$ 0.29
Average common shares outstanding	3,281,719	3,261,831	3,291,697	3,456,993	3,473,670
Average common and common equivalent shares	3,281,719	3,273,722	3,319,225	3,515,852	3,514,709
Shares outstanding at year end	3,304,339	3,290,219	3,299,163	3,491,337	3,600,467
Other Key Ratios					
Nonperforming assets to total assets	4.09%	4.97%	3.84%	0.77%	0.02%
Nonperforming loans to loans and leases held for investment	5.10%	6.94%	4.22%	1.09%	0.03%
Net loan charge-offs to average loans and leases held for investment	(1.530)%	(3.235)%	(1.066)%	(0.129)%	(0.008)%
Allowance for credit losses to total loans[2]	3.62%	3.11%	1.50%	1.26%	0.86%
Allowance for credit losses to total loans[3]	3.84%	-	-	-	-
Allowance for credit losses to total nonperforming loans[2]	92%	50%	38%	122%	3,304%
Allowance for credit losses to total nonperforming loans[3]	83%	-	-	-	-

(1) Loss from continuing operations was $(3.069) million for 2007. Net income for 2007 was $1.980 million.

(2) Excluding impact of pending sale

(3) Including impact of pending sale

Quarterly Financial Data

	2010				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	YTD
			(Unaudited)		
Interest income	$ 9,289	$ 8,451	$ 8,133	$ 7,637	$ 33,510
Interest expense	2,951	2,638	2,356	2,293	10,238
Net interest income	6,338	5,813	5,777	5,344	23,272
Provision for credit losses	2,000	1,500	1,250	1,000	5,750
Net interest income after provision for credit losses	4,338	4,313	4,527	4,344	17,522
Non-interest income	6,286	5,560	5,603	6,524	23,973
Fraud loss on assets serviced by others	-	26,231	-	-	26,231
Non-interest expense, excluding fraud loss on assets serviced by others	8,482	8,743	9,692	10,340	37,257
Income (loss) before income taxes	2,142	(25,101)	438	528	(21,993)
Income tax expense (benefit)	(48)	120	-	-	72
NET INCOME (LOSS)	$ 2,190	$ (25,221)	$ 438	$ 528	$ (22,065)
Preferred stock costs	(324)	(331)	(337)	(341)	(1,333)
Net income (loss) available to common shareholders	$ 1,866	$ (25,552)	$ 101	$ 187	$ (23,398)
Basic earnings (loss) per common share	$ 0.57	$ (7.79)	$ 0.03	$ 0.06	$ (7.13)
Diluted earnings (loss) per common share	$ 0.57	$ (7.79)	$ 0.03	$ 0.06	$ (7.13)
Average common shares:					
Basic	3,281,719	3,281,719	3,281,719	3,281,719	3,281,719
Diluted	3,281,719	3,281,719	3,281,719	3,281,719	3,281,719

	2009				
	First Quarter	**Second Quarter**	**Third Quarter**	**Fourth Quarter**	**YTD**
			(Unaudited)		
Interest income	$ 10,679	$ 11,413	$ 11,611	$ 10,885	$ 44,588
Interest expense	3,797	3,797	3,758	3,547	14,899
Net interest income	6,882	7,616	7,853	7,338	29,689
Provision for credit losses	1,700	2,000	22,300	1,000	27,000
Net interest income (loss) after provision for credit losses	5,182	5,616	(14,447)	6,338	2,689
Non-interest income	3,696	4,345	3,488	4,484	16,013
Non-interest expense	8,060	9,390	12,745	8,908	39,103
Income (loss) before income taxes	818	571	(23,704)	1,914	(20,401)
Income tax expense (benefit)	202	48	(1,814)	(61)	(1,625)
NET INCOME (LOSS)	$ 616	$ 523	$ (21,890)	$ 1,975	$ (18,776)
Preferred stock costs	(266)	(327)	(330)	(331)	(1,254)
Net income (loss) available to common shareholders	$ 350	$ 196	$ (22,220)	$ 1,644	$ (20,030)
Basic earnings (loss) per common share	$ 0.11	$ 0.06	$ (6.81)	$ 0.50	$ (6.14)
Diluted earnings (loss) per common share	$ 0.11	$ 0.06	$ (6.81)	$ 0.50	$ (6.14)
Average common shares:					
Basic	3,261,831	3,261,831	3,261,831	3,275,279	3,261,831
Diluted	3,274,595	3,290,400	3,269,355	3,275,279	3,273,722

Business

General

BNCCORP, INC. (BNCCORP or the Company) is a bank holding company headquartered in Bismarck, North Dakota. It is the parent company of BNC National Bank (the Bank). The Company operates community banking and wealth management businesses in Arizona, Minnesota and North Dakota from 18 locations. BNC also conducts mortgage banking from 10 locations in Arizona, Minnesota, Iowa, Kansas, Nebraska and Missouri.

Operating Strategy

In our banking and wealth management operations we provide relationship-based services to small and mid-sized businesses, business owners, professionals and consumers in our primary market areas of Arizona, Minnesota and North Dakota. Key elements of our operating strategy are:

- Emphasize deposit growth;
- Manage credit risk;
- Provide individualized, high-level customer service;
- Offer diversified products and services; and
- Expand opportunistically.

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

Overview

The following table summarizes selected income statement data and earnings (loss) per share data (in thousands, except per share data):

	2010	2009
SELECTED INCOME STATEMENT DATA		
Interest income	$ 33,510	$ 44,588
Interest expense	10,238	14,899
Net interest income	23,272	29,689
Provision for credit losses	5,750	27,000
Non-interest income	23,973	16,013
Fraud loss on assets serviced by others	26,231	-
Non-interest expense, excluding fraud loss on assets serviced by others	37,257	39,103
Loss before income taxes	(21,993)	(20,401)
Income tax expense (benefit)	72	(1,625)
Net loss	(22,065)	(18,776)
Preferred stock costs	(1,333)	(1,254)
Net loss available to common shareholders	$ (23,398)	$ (20,030)
EARNINGS PER SHARE DATA		
Basic loss per common share	$ (7.13)	$ (6.14)
Diluted loss per common share	$ (7.13)	$ (6.14)

The following is an overview of recent periods:

- The loss in 2010 is attributed to a fraud committed by a third party servicer of loans owned by BNC. See Note 4 of our Consolidated Financial Statements.
- The losses in 2009 are primarily attributed to provisions for credit losses and ORE write-downs and costs related to nonperforming loans and foreclosed assets. For more information see discussion of loans, the allowance for credit losses and OREO that follows in the MD&A as well as Notes 8, 9 and 10 of our Consolidated Financial Statements.
- Net interest income decreased in 2010 due to lower rates and reduced asset balances. For more information see discussion of net interest income that follows in the MD&A.
- Non-interest income has been higher in recent years primarily due to growth in mortgage banking operations. For more information see discussion of non-interest income that follows in the MD&A.
- Non-interest expenses significantly increased by the fraud loss on assets serviced by others in 2010 and include higher costs for foreclosed assets, mortgage banking operations and regulatory costs. See Note 4 of our Consolidated Financial Statements.
- In November 2010, we announced an agreement to sell loans, other assets and deposits in our Arizona and Minnesota markets. See Note 3 of our Consolidated Financial Statements.

General

Net loss in 2010 was $(22.065) million, or $(7.13) per diluted share, compared to a net loss of $(18.776) million, or $(6.14) per diluted share in 2009.

Net Interest Income

The following table sets forth information relating to our average balance sheet information, yields on interest-earning assets and costs on interest-bearing liabilities (dollars are in thousands):

Analysis of Changes in Net Interest Income

	For the Year ended December 31, 2010			For the Year ended December 31, 2009			For the Year ended December 31, 2008		
	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost
	(dollars in thousands)			(dollars in thousands)			(dollars in thousands)		
Assets									
Federal funds sold/interest-bearing due from	$ 47,470	$ 111	0.23%	$ 5,755	$ 9	0.16%	$ 95	$ 1	1.05%
Taxable investments	167,572	8,631	5.15%	226,309	14,397	6.36%	172,383	9,864	5.72%
Tax-exempt investments	2,111	93	4.41%	8,165	409	5.01%	16,994	839	4.94%
Loans held for sale-mortgage banking	29,039	1,263	4.35%	23,570	1,182	5.01%	3,586	220	6.13%
Participating interests in mortgage loans	20,144	665	3.30%	29,683	1,312	4.42%	24,688	1,408	5.70%
Loans and leases held for investment	478,492	22,747	4.75%	547,336	27,279	4.98%	525,311	33,694	6.41%
Allowance for credit losses	(17,201)	-		(11,962)	-		(7,105)	-	
Total interest-earning assets	727,627	33,510	4.61%	828,856	44,588	5.38%	735,952	46,026	6.25%
Non-interest-earning assets:									
Cash and due from banks	9,929			9,749			10,481		
Other	53,146			61,611			47,835		
Total assets	$ 790,702			$ 900,216			$ 794,268		
Liabilities and Stockholders' Equity									
Deposits:									
Interest checking and money market accounts	$ 282,880	1,729	0.61%	$ 266,537	2,379	0.89%	$ 244,279	4,074	1.67%
Savings	11,156	11	0.10%	11,685	13	0.11%	9,859	33	0.33%
Certificates of deposit:									
Under $100,000	241,036	6,070	2.52%	324,902	8,653	2.66%	232,367	8,981	3.87%
$100,000 and over	45,083	998	2.21%	47,358	1,341	2.83%	58,378	2,011	3.44%
Total interest-bearing deposits	580,155	8,808	1.52%	650,482	12,386	1.90%	544,883	15,099	2.77%
Borrowings:									
Short-term borrowings	11,163	73	0.65%	17,953	179	1.00%	7,049	144	2.04%
FHLB advances	2,899	112	3.86%	51,738	1,078	2.08%	87,159	2,291	2.63%
Other borrowings	10	1	10.00%	58	3	5.17%	519	25	4.82%
Subordinated debentures	23,491	1,244	5.30%	22,686	1,253	5.52%	22,734	1,656	7.29%
Total interest-bearing liabilities	617,718	10,238	1.66%	742,917	14,899	2.01%	662,344	19,215	2.90%
Non-interest-bearing demand accounts	117,459			77,736			66,388		
Total deposits and interest-bearing liabilities	735,177			820,653			728,732		
Other non-interest-bearing liabilities	9,272			8,679			7,928		
Total liabilities	744,449			829,332			736,660		
Stockholders' equity	46,253			70,884			57,608		
Total liabilities and stockholders' equity	$ 790,702			$ 900,216			$ 794,268		
Net interest income		$ 23,272			$ 29,689			$ 26,811	
Net interest spread			2.95%			3.37%			3.35%
Net interest margin			3.20%			3.58%			3.64%
Ratio of average interest-earning assets to average interest-bearing liabilities	117.79%			111.57%			111.11%		

The following table allocates changes in our interest income and interest expense between the changes related to volume and rates:

	For the Years Ended December 31, 2010 Compared to 2009			For the Years Ended December 31, 2009 Compared to 2008		
	Change Due to			Change Due to		
	Volume	Rate	Total	Volume	Rate	Total
		(in thousands)			(in thousands)	
Interest Earned on Interest-Earning Assets						
Federal funds sold/interest-bearing due from	$ 95	$ 7	$ 102	$ 10	$ (2)	$ 8
Taxable investments	(3,326)	(2,440)	(5,766)	3,340	1,193	4,533
Tax-exempt investments	(272)	(44)	(316)	(442)	12	(430)
Loans held for sale–mortgage banking	251	(170)	81	1,114	(152)	962
Participating interests in mortgage loans	(362)	(285)	(647)	255	(351)	(96)
Loans held for investment	(3,315)	(1,217)	(4,532)	1,362	(7,777)	(6,415)
Total increase (decrease) in interest income	(6,929)	(4,149)	(11,078)	5,639	(7,077)	(1,438)
Interest Expense on Interest-Bearing Liabilities						
Interest checking and money market accounts	138	(788)	(650)	343	(2,038)	(1,695)
Savings	(1)	(1)	(2)	5	(25)	(20)
Certificates of Deposit:						
Under $100,000	(2,133)	(450)	(2,583)	2,952	(3,280)	(328)
$100,000 and over	(62)	(281)	(343)	(345)	(325)	(670)
Short-term borrowings	(56)	(50)	(106)	137	(102)	35
FHLB advances	(1,474)	508	(966)	(803)	(410)	(1,213)
Other borrowings	(4)	2	(2)	(24)	2	(22)
Subordinated debentures	45	(54)	(9)	(3)	(400)	(403)
Total increase (decrease) in interest expense	(3,547)	(1,114)	(4,661)	2,262	(6,578)	(4,316)
Increase (decrease) in net interest income	$ (3,382)	$ (3,035)	$ (6,417)	$ 3,377	$ (499)	$ 2,878

Net interest income was $23.272 million in 2010 compared to $29.689 million in 2009, a decrease of $(6.417) million or (21.6)%. The net interest margin decreased to 3.20% for the year ended December 31, 2010, from 3.58% in 2009.

In 2010 lower rates and lower balances of assets and liabilities combined to reduce net interest income. Net interest income in 2010 was also lower than in 2009 as we recognized income of $1.550 million in 2009 related to an interest rate floor which expired very early in 2010. Nonperforming assets have also negatively impacted net interest income in recent periods. During 2010, cash balances were very significant for most of the year in order to maintain the liquidity needed to finance the sale of deposits discussed in Note 3 of our Consolidated Financial Statements.

Interest income decreased in 2009 primarily due to the lower interest rate environment. The impact of lower interest rates was partially offset by an increase in investments. We emphasized investments in 2009 because we

believed the yield on investments was attractive compared to other assets. Increases in nonperforming assets reduced interest income.

Interest expense decreased in 2009 primarily due to lower interest rates. Increases in the balances of deposits partially offset the decline in rates.

Net interest income was $29.689 million in 2009 compared to $26.811 million in 2008, an increase of $2.878 million or 10.7%. The net interest margin decreased to 3.58% for the year ended December 31, 2009, from 3.64% in 2008. Investment earnings and lower interest rates on liabilities combined to increase net interest income. Increases in non-accrual loans and other nonperforming assets compressed net interest margin.

Non-interest Income

The following table presents the major categories of our non-interest income (dollars are in thousands):

	For the Years Ended December 31,		Increase (Decrease) 2010 – 2009		
	2010	2009	$	%	
Bank charges and service fees	$ 2,533	$ 2,332	$ 201	9 %	
Wealth management revenues	2,133	2,056	7	4 %	(a)
Mortgage banking revenues	13,424	8,390	5,034	60 %	(b)
Gains (losses) on sales of loans, net	371	(339)	710	(209) %	(c)
Gains on sales of securities, net	4,390	2,850	1,540	54 %	(d)
Other	1,122	724	398	55 %	(e)
Total non-interest income	$ 23,973	$ 16,013	$ 7,960	50 %	

(a) Although wealth management revenues increased, we exited two lines of business in 2010. Our ESOP revenues and fees for managing documents on insurance products sold by others declined. As a result, we expect wealth management revenues to trend lower in future periods.

(b) Mortgage banking revenues increased because we have been expanding these operations in recent years. Low interest rates and governmental support for the housing market have also contributed to higher mortgage banking revenues in recent periods. It is uncertain how long these favorable conditions will continue.

(c) In 2009 we sold commercial real estate loans at a loss to reduce our credit exposure. In 2010 we began to sell SBA loans at gains. We anticipate more sales of SBA loans in 2011.

(d) Gains on sales of securities, net vary depending on the nature and volume of transactions.

(e) In 2010 we sold a branch for a gain.

Non-interest Expense

The following table presents the major categories of our non-interest expense (dollars are in thousands):

	For the Years Ended December 31,		Increase (Decrease) 2010– 2009		
	2010	2009	$	%	
Salaries and employee benefits	$ 16,080	$ 15,008	$ 1,072	7 %	
Professional services	5,068	3,064	2,004	65 %	(a)
Other real estate costs	2,707	8,169	(5,462)	(67) %	(b)
Occupancy	2,885	2,508	377	15 %	(c)
Data processing fees	2,697	2,330	367	16 %	(d)
Regulatory costs	1,951	1,466	485	33 %	(e)
Marketing and promotion	1,372	1,277	95	7 %	
Depreciation and amortization	1,333	1,465	(132)	(9) %	
Office supplies and postage	603	611	(8)	(1) %	
Fraud loss on assets serviced by others	26,231	-	26,231	100 %	(f)
Other	2,561	3,205	(644)	(20) %	(g)
Total non-interest expense	$ 63,488	$ 39,103	$ 24,385	62 %	
Efficiency ratio	134.38%	85.56%	48.82%		

(a) Professional services increased because of legal fees associated with problem credits, services required by mortgage banking operations and costs related to the fraud loss on assets serviced by others.
(b) Other real estate costs will vary depending on the level of foreclosed assets and valuation allowances recorded to reduce the carrying value of foreclosed properties.
(c) Occupancy has increased due to more mortgage banking locations
(d) Data processing fees increased due to the increased mortgage banking activity.
(e) Regulatory assessments for deposit insurance and regular examinations have been increasing significantly in recent periods.
(f) For information related to the fraud loss see Note 4 of our Consolidated Financial Statements.
(g) Other expenses decreased primarily due to an impairment of goodwill aggregating $409 thousand in the third quarter of 2009.

Income Tax Expense

Tax expense of $72 thousand was recognized in 2010. Although the Company has net operating loss carryforwards aggregating $3.657 million for federal tax purposes, a provision for taxes was recorded for state tax obligations. Due to tax loss carryforwards and attributes related to net deferred tax assets, the Company is not likely to record income tax expense for several profitable periods.

In 2009, the tax benefit was $1.625 million, or 8.0% of pre-tax losses. This benefit reflects the net effect of tax benefits resulting from operating losses and the cost of recording a valuation allowance for net deferred tax assets.

Financial Condition

Assets

The following table presents our assets by category (dollars are in thousands):

	As of December 31,		Increase (Decrease) 2010 – 2009		
	2010	2009	$	%	
Cash and cash equivalents	$ 112,847	$ 35,362	$ 77,485	219 %	(a)
Investment securities available for sale	137,032	212,661	(75,629)	(36) %	(b)
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	2,862	3,048	(186)	(6) %	(c)
Loans held for sale-mortgage banking	29,116	24,130	4,986	21 %	(d)
Participating interests in mortgage loans	4,888	38,534	(33,646)	(87) %	(e)
Loans and leases held for investment, net	335,736	499,061	(163,325)	(33) %	(f)
Other loans held for sale	70,501	-	70,501	100 %	(g)
Other real estate, net	12,706	7,253	5,453	75 %	(h)
Premises and equipment, net	16,684	20,422	(3,738)	(18) %	(i)
Interest receivable	2,138	2,970	(832)	(28) %	(j)
Other assets	19,790	24,642	(4,852)	(20) %	(k)
Premises and equipment held for sale, net	2,769	-	2,769	100 %	(i)
Total assets	$ 747,069	$ 868,083	$ (121,014)	(14) %	

(a) We have been increasing liquid assets as part of a focus on managing liquidity and maintaining funds to finance the sale of deposits. As a result, cash balances increased. Cash balances can also vary significantly on a daily basis.
(b) Investments decreased due to sales and repayments. Proceeds have been held in cash and cash equivalents.
(c) Investments in these stocks are mandated by third parities. Our required investment decreased due to reduced FHLB advances.
(d) Loans held for sale–mortgage banking have increased as we expanded mortgage banking operations.
(e) Participating interests in mortgage loans represent loans purchased from counterparties who service the assets for us. In 2010 the balances decreased because one of the counterparties committed fraud. These balances will vary depending on the volume of loans originated by the counterparties. See Note 4 of our Consolidated Financial Statements.
(f) Loans and leases held for investment have decreased as we have attempted to manage our credit exposure by reducing loans outstanding and increasing the allowance for credit losses.
(g) In November 2010, we entered into an agreement to sell certain loans. See Note 3 of our Consolidated Financial Statements.
(h) ORE increased due to more foreclosure activity. See Note 10 of our Consolidated Financial Statements..
(i) As part of the agreement to sell certain assets and liabilities as announced in November, 2010, we agreed to sell certain premises and equipment. See Note 3 of our Consolidated Financial Statements.
(j) Accrued interest receivable decreased due to lower rates and lower balances of earning assets.
(k) Other assets decreased due to the receipt of tax refunds in 2010 related to loss carryback periods.

Investment Securities Available for Sale

The following table presents the composition of the available-for-sale investment portfolio (in thousands):

Investment Portfolio Composition

	December 31,					
	2010		2009		2008	
	Amortized cost	Estimated fair market value	Amortized cost	Estimated fair market value	Amortized cost	Estimated fair market Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	$ 965	$ 1,000	$ 1,223	$ 1,262	$ 1,505	$ 1,543
U.S. government agency mortgage-backed securities issued by FNMA	1,863	1,978	2,500	2,599	2,891	2,917
Collateralized mortgage obligations guaranteed by GNMA	89,056	89,689	86,600	87,017	23,037	23,170
Collateralized mortgage obligations issued by FNMA or FHLMC	930	997	1,797	1,887	37,896	39,024
Other collateralized mortgage obligations	39,518	41,255	118,375	117,211	138,851	129,185
State and municipal bonds	1,911	2,113	2,521	2,685	13,482	14,018
Total investments	$ 134,243	$ 137,032	$ 213,016	$ 212,661	$ 217,662	$ 209,857

See Note 1 of our Consolidated Financial Statements for management's conclusion on other than temporary impairment.

The following table presents contractual maturities for securities available for sale and yields thereon at December 31, 2010 (dollars are in thousands):

Investment Portfolio

	Within 1 year		After 1 but within 5 years		After 5 but within 10 years		After 10 years		Total	
	Amount	Yield (1)	Amount	Yield (1)	Amount	Yield (1)	Amount	Yield (1)	Amount	Yield (1)
U.S. government agency mortgage-backed securities guaranteed by GNMA(2) (3)	$ -	0.00%	$ -	0.00%	$ 965	5.52%	$ -	0.00%	$ 965	5.52%
U.S. government agency mortgage-backed securities issued by FNMA(2) (3)	-	0.00%	-	0.00%	-	0.00%	1,863	6.50%	1,863	6.55%
Collateralized mortgage obligations guaranteed by GNMA(2) (3)	-	0.00%	-	0.00%	5,142	0.91%	83,914	2.65%	89,056	2.55%
Collateralized mortgage obligations issued by FNMA or FHLMC(2) (3)	-	0.00%	-	0.00%	184	7.56%	746	6.06%	930	6.35%
Other collateralized mortgage obligations(2) (3)	-	0.00%	-	0.00%	3,660	8.16%	35,858	8.82%	39,518	8.76%
State and municipal bonds(2)	-	0.00%	-	0.00%	1,139	7.55%	772	8.02%	1,911	7.74%
Total book value of investment securities	$ -	0.00%	$ -	0.00%	$ 11,090	4.50%	$ 123,153	4.56%	$ 134,243	4.55%
Unrealized holding gain on securities available for sale									2,789	
Total investment in securities available for sale									$ 137,032	4.46%

(1) Yields include adjustments for tax-exempt income.
(2) Based on amortized cost rather than fair value.
(3) Maturities of mortgage-backed securities and collateralized obligations are based on contractual maturities. Actual maturities may vary because obligors may have the right to call or prepay obligations with or without call or prepayment penalties.

As of December 31, 2010, we had $137.0 million of available-for-sale securities in the investment portfolio compared to $212.7 million and $209.9 million at December 31, 2009 and 2008, respectively.

In 2010, investment securities decreased through sales and principal paydowns in order to manage liquidity and capital. Net unrealized losses decreased and the portfolio had net unrealized gains as of December 31, 2010. The unrealized gains are due to the narrowing of credit spread, the return of principal on securities, and the general decline in market interest rates. During 2010, we realized $4.390 million of gains on sales of securities. See Notes 1 and 6 of our Consolidated Financial Statements for a discussion of impairment assessments.

At December 31, 2010, we held four securities, other than U.S. Government Agency CMOs, that exceeded 10% of stockholders' equity. The total carrying value of these four securities was $20.7 million. A significant portion of our investment securities portfolio was pledged as collateral. See Note 6 of our Consolidated Financial Statements for the amount of investments that serve as collateral.

Federal Reserve Bank and Federal Home Loan Bank of Des Moines Stock
Our equity securities consisted of $1.8 million of Federal Reserve Bank ("FRB") stock as of December 31, 2010 and $1.3 million as of December 31, 2009, and $1.1 million and $1.8 million of FHLB of Des Moines stock as of December 31, 2010 and 2009, respectively.

Loan Portfolio
The following table presents the composition of our loan portfolio (dollars are in thousands):

	December 31,											
	2010				2009		2008		2007		2006	
	Loans and Leases, excluding Loans Held for Sale-Mortgage Banking	Other Loans Held for Sale	Total Loans and Leases Held for Investment	%	Total Loans and Leases Held for Investment	%	Total Loans and Leases Held for Investment	%	Total Loans and Leases Held for Investment	%	Total Loans and Leases Held for Investment	%
Commercial and industrial	$ 93,859	$ 17,242	$ 76,617	22.5	$ 124,773	23.2	$ 138,671	24.6	$ 125,555	24.4	$ 100,127	25.9
Real estate mortgage	262,597	50,745	211,852	62.2	266,051	49.5	265,360	47.2	181,000	35.1	124,551	32.2
Real estate construction	44,289	3,303	40,986	12.0	96,327	17.9	108,713	19.3	167,345	32.5	89,619	23.2
Participating interests in mortgage loans	4,888	-	4,888	1.4	38,534	7.2	28,584	5.1	24,357	4.7	56,125	14.5
Agricultural	15,114	-	15,114	4.4	23,142	4.3	22,023	3.9	17,074	3.3	14,286	3.7
Other	7,211	982	6,229	1.8	7,397	1.4	8,793	1.5	7,693	1.5	6,037	1.6
Total principal amount of loans	427,958	72,272	355,686	104.4	556,224	103.5	572,144	101.6	523,024	101.5	390,745	101.0
Unearned income and net unamortized deferred fees and costs	(357)	(60)	(297)	(0.1)	(582)	(0.1)	(807)	(0.1)	(1,111)	(0.2)	(686)	(0.2)
Loans, net of unearned income and unamortized fees and costs	427,601	72,212	355,389	104.3	555,642	103.4	571,337	101.5	521,913	101.3	390,059	100.9
Less allowance for credit losses	(16,476)	(1,711)	(14,765)	(4.3)	(18,047)	(3.4)	(8,751)	(1.5)	(6,599)	(1.3)	(3,370)	(0.9)
Net loans	$ 411,125	$ 70,501	$ 340,624	100.0	$ 537,595	100.0	$ 562,586	100.0	$ 515,314	100.0	$ 386,689	100.0

Change in Loan Portfolio Composition

	As of December 31,				Increase (Decrease) 2010 – 2009		
	2010			2009	$	%	
	Loans and Leases, excluding Loans Held for Sale-Mortgage Banking	Other Loans Held for Sale	Total Loans and Leases Held for Investment	Total Loans and Leases Held for Investment			
Commercial and industrial	$ 93,859	$ 17,242	$ 76,617	$ 124,773	$ (48,156)	(39)%	(a)
Real estate mortgage	262,597	50,745	211,852	266,051	(54,199)	(20)%	(a)
Real estate construction	44,289	3,303	40,986	96,327	(55,341)	(57)%	(b)
Participating interests in mortgage loans	4,888	-	4,888	38,534	(33,646)	(87)%	(c)
Agricultural	15,114	-	15,114	23,142	(8,028)	(35)%	(a)
Other	7,211	982	6,229	7,397	(1,168)	(16)%	
Total principal amount of loans	427,958	72,272	355,686	556,224	(200,538)	(36)%	
Unearned income and net unamortized deferred fees and costs	(357)	(60)	(297)	(582)	285	(49)%	
Loans, net of unearned income and unamortized fees and costs	427,601	72,212	355,389	555,642	(200,253)	(36)%	
Less allowance for credit losses	(16,476)	(1,711)	(14,765)	(18,047)	3,282	(18)%	
Net loans	$ 411,125	$ 70,501	$ 340,624	$ 537,595	$ (196,971)	(37)%	

(a) Loan balances have generally decreased due to repayments, charge-offs and our efforts to reduce credit exposure. Loans held for investment have also declined as a result of an agreement entered into in November 2010 to sell certain loans. See Note 3 of our Consolidated Financial Statements.
(b) Construction loans have decreased because certain projects under construction have been completed and certain problem loans were charged-off during the year.
(c) Participating interests in mortgage loans represent loans purchased from counterparties who service the assets for us. In 2010, the balances decreased because one of the counterparties committed fraud. These balances will vary depending on the volume of loans originated by the counterparties. See Note 4 of our Consolidated Financial Statements.

Loan Participations

Pursuant to our lending policy, loans may not exceed 85% of the Bank's legal lending limit (except to the extent collateralized by U.S. Treasury securities or Bank deposits and, accordingly, excluded from the Bank's legal lending limit) unless the Chief Credit Officer and the Executive Credit Committee grant prior approval. To accommodate customers whose financing needs exceed lending limits and internal loan concentration limits, the Bank sells loan participations to outside participants without recourse.

Loan participations sold on a nonrecourse basis to outside financial institutions were as follows as of the dates indicated:

Loan Participations Sold

December 31,	(in thousands)
2010	$ 259,939
2009	330,204
2008	315,469
2007	201,776
2006	188,994

Concentrations of Credit

The following tables summarize the location of our borrowers as of December 31 (in thousands):

	2010				2009	
	Loans and Leases, excluding Loans Held for Sale-Mortgage Banking	Other Loans Held for Sale	Total Loans and Leases Held for Investment		Total Loans and Leases Held for Investment	
North Dakota	$ 172,698	$ 2,116	$ 170,582	48%	$ 199,831	36%
Minnesota	126,461	36,206	90,255	25	154,007	28
Arizona	71,943	31,125	40,818	12	125,579	22
Other	56,856	2,825	54,031	15	76,807	14
Total gross loans held for investment	427,958	72,272	355,686	100 %	556,224	100 %
Unearned income and net unamortized deferred fees and costs	(357)	(60)	(297)		(582)	
Allowance for credit losses	(16,476)	(1,711)	(14,765)		(18,047)	
Net loans and leases	$ 411,125	$ 70,501	$ 340,624		$ 537,595	

Our borrowers use loan proceeds for projects in various geographic areas. The following table summarizes the locations where our borrowers are using loan proceeds as of December 31 (in thousands):

	2010				2009	
	Loans and Leases, excluding Loans Held for Sale-Mortgage Banking	**Other Loans Held for Sale**	**Total Loans and Leases Held for Investment**		**Total Loans and Leases Held for Investment**	
North Dakota	$ 162,364	$ -	$ 162,364	46 %	$ 184,282	33 %
Arizona	84,966	33,335	51,631	14	134,967	24
California	31,736	40	31,696	9	39,848	7
Minnesota	56,985	29,537	27,448	8	81,514	15
Texas	28,108	1,347	26,761	7	28,944	5
Kentucky	10,717	-	10,717	3	11,927	2
Idaho	9,095	-	9,095	3	9,292	2
Wisconsin	7,515	515	7,000	2	9,840	2
Colorado	6,333	-	6,333	2	-	-
Georgia	6,323	1,674	4,649	1	6,465	1
Other	23,816	5,824	17,992	5	49,145	9
Total gross loans held for investment	427,958	72,272	355,686	100 %	556,224	100 %
Unearned income and net unamortized deferred fees and costs	(357)	(60)	(297)		(582)	
Allowance for credit losses	(16,476)	(1,711)	(14,765)		(18,047)	
Net loans and leases	$ 411,125	$ 70,501	$ 340,624		$ 537,595	

The following table presents loans by type within our three primary states as of December 31 (in thousands):

	2010			2009
	Loans and Leases, excluding Loans Held for Sale-Mortgage Banking	Other Loans Held for Sale	Total Loans and Leases Held for Investment	Total Loans and Leases Held for Investment
North Dakota				
Commercial and industrial	$ 80,536	$ -	$ 80,536	$ 84,400
Construction	1,029	-	1,029	4,572
Agricultural	13,673	-	13,673	22,422
Land and land development	10,682	-	10,682	12,321
Owner-occupied commercial real estate	24,941	-	24,941	27,960
Non-owner-occupied commercial real estate	12,567	-	12,567	12,419
Small business administration	3,116	-	3,116	2,434
Consumer/participating interests	15,820	-	15,820	17,754
Subtotal	$ 162,364	$ -	$ 162,364	$ 184,282
Arizona				
Commercial and industrial	$ 9,243	$ 8,637	$ 606	$ 19,740
Construction	-	-	-	2,136
Agricultural	-	-	-	-
Land and land development	8,621	-	8,621	18,541
Owner-occupied commercial real estate	19,286	18,472	814	23,508
Non-owner-occupied commercial real estate	28,560	1,763	26,797	32,497
Small business administration	8,937	1,491	7,446	5,042
Consumer/participating interests	10,319	2,972	7,347	33,503
Subtotal	$ 84,966	$ 33,335	$ 51,631	$ 134,967
Minnesota				
Commercial and industrial	$ 3,656	$ 3,029	$ 627	$ 10,589
Construction	2,002	-	2,002	4,698
Agricultural	30	-	30	33
Land and land development	7,903	3,303	4,600	12,641
Owner-occupied commercial real estate	16,555	15,819	736	18,675
Non-owner-occupied commercial real estate	19,524	2,102	17,422	25,203
Small business administration	885	827	58	1,025
Consumer/participating interests	6,430	4,457	1,973	8,650
Subtotal	$ 56,985	$ 29,537	$ 27,448	$ 81,514

Loan Maturities

The following table sets forth the remaining maturities of loans in our portfolio as of December 31, 2010 (in thousands):

Maturities of Loans[1]

	One year or less	Over 1 year through 5 years Fixed rate	Over 1 year through 5 years Floating rate	Over 5 years Fixed rate	Over 5 years Floating rate	Total Loans and Leases Held for Investment
Commercial and industrial	$ 37,288	$ 25,081	$ 1,075	$ 7,342	$ 5,831	$ 76,617
Real estate mortgage	64,431	65,097	39,966	18,507	23,851	211,852
Real estate construction	18,138	6,014	12,412	321	4,101	40,986
Participating interests in mortgage loans	4,888	-	-	-	-	4,888
Agricultural	4,838	6,410	705	625	2,536	15,114
Other	1,907	3,326	290	100	606	6,229
Total principal amount of loans	$ 131,490	$ 105,928	$ 54,448	$ 26,895	$ 36,925	$ 355,686

(1) Maturities are based on contractual maturities. Floating rate loans include loans that would reprice prior to maturity if base rates change.

Actual maturities may differ from the contractual maturities shown above as a result of renewals and prepayments. Loan renewals are evaluated in substantially the same manner as new credit applications.

Provision for Credit Losses

We provide for credit losses to maintain our allowance for credit losses at a level adequate to cover estimated probable losses inherent in the loan and lease portfolio as of each balance sheet date. The provision for credit losses for the year ended December 31, 2010 was $5.750 million as compared to $27.000 million in 2009. The higher provision for credit losses in recent periods reflects macroeconomic forces which impaired the ability of borrowers to repay debt which resulted in higher credit losses throughout the financial industry. During 2009, our nonperforming loans increased significantly and our provision for credit losses increased accordingly. In 2010, the balance of our nonperforming loans decreased significantly which contributed to the decrease in our provision for credit losses.

Allowance for Credit Losses

See a discussion of critical accounting policies in Note 1 of our Consolidated Financial Statements for a summary of the processes we use to estimate the allowance for credit losses.

The following table summarizes activity in the allowance for credit losses and certain ratios:

Analysis of Allowance for Credit Losses

(dollars are in thousands)	For the Years ended December 31,				
	2010	2009	2008	2007	2006
Balance of allowance for credit losses, beginning of period	$ 18,047	$ 8,751	$ 6,599	$ 3,370	$ 3,188
Charge-offs:					
Commercial and industrial	(3,732)	(6,408)	(738)	(1,504)	(19)
Real estate mortgage	(735)	(2,258)	(426)	(500)	-
Real estate construction	(3,238)	(9,080)	(4,529)	-	-
Agricultural	-	-	-	-	-
Other	(81)	(130)	(253)	(123)	(32)
Total charge-offs	(7,786)	(17,876)	(5,946)	(2,127)	(51)
Recoveries:					
Commercial and industrial	19	12	84	1,500	3
Real estate mortgage	309	1	-	-	-
Real estate construction	127	149	196	-	-
Agricultural	-	-	-	-	-
Other	10	10	68	106	20
Total recoveries	465	172	348	1,606	23
Net charge-offs	(7,321)	(17,704)	(5,598)	(521)	(28)
Provision for credit losses charged to operations	5,750	27,000	7,750	3,750	210
	16,476	18,047	8,751	6,599	3,370
Transferred to other loans held for sale	(1,711)	-	-	-	-
Balance of allowance for credit losses, end of period	$ 14,765	$ 18,047	$ 8,751	$ 6,599	$ 3,370
Ratio of net charge-offs to average total loans	(1.387)%	(2.948)%	(0.507)%	(0.121)%	(0.008)%
Ratio of net charge-offs to average loans and leases held for investment	(1.530)%	(3.235)%	(0.534)%	(0.129)%	(0.008)%
Average gross loans and leases held for investment	$ 478,492	$ 547,336	$ 525,311	$ 402,615	$ 334,058
Ratio of allowance for credit losses to loans and leases held for investment(1)	4.70%	3.49%	1.61%	1.33%	1.01%
Ratio of allowance for credit losses to loans and leases held for investment(2)	4.21%	-	-	-	-
Ratio of allowance for credit losses to total nonperforming loans(1)	92%	50%	38%	122%	3,304%
Ratio of allowance for credit losses to total nonperforming loans(2)	83%	-	-	-	-
Allowance for credit losses to total loans(1)	3.62%	3.11%	1.50%	1.26%	0.86%
Allowance for credit losses to total loans(2)	3.84%	-	-	-	-

(1) Excluding impact of pending sale
(2) Including impact of pending sale

The allowance for credit losses has been elevated in recent periods because of an increase in nonperforming assets and deteriorating economic conditions.

See Notes 1 and 9 of our Consolidated Financial Statements and "Critical Accounting Policies" for further information concerning accounting policies associated with the allowance for credit losses.

The table below presents an allocation of the allowance for credit losses among the various loan categories and sets forth the percentage of loans in each category to gross loans. The allocation of the allowance for credit losses as shown in the table should neither be interpreted as an indication of future charge-offs, nor as an indication that charge-offs in future periods will necessarily occur in these amounts or in the indicated proportions.

Allocation of the Allowance for Loan Losses

(dollars are in thousands)

	December 31,											
	2010				2009		2008		2007		2006	
	Loans and Leases Allowance	Other Loans Held for Sale Allowance	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment
Commercial and industrial (a)	$ 1,653	$ 575	$ 1,078	22%	$ 5,779	23%	$ 1,268	24%	$ 1,410	24%	$ 1,602	26%
Real estate mortgage (b)	12,493	1,087	11,406	60%	6,672	48%	2,829	47%	1,956	35%	838	32%
Real estate construction (a)	2,031	36	1,995	11%	4,692	17%	4,293	19%	2,740	32%	534	23%
Participating interests in mortgage loans	14	-	14	1%	105	7%	86	5%	85	5%	140	14%
Agricultural	174	-	174	4%	704	4%	180	4%	276	3%	171	4%
Other	111	13	98	2%	95	1%	95	1%	132	1%	85	1%
Total	$ 16,476	$ 1,711	$ 14,765	100%	$ 18,047	100%	$ 8,751	100%	$ 6,599	100%	$ 3,370	100%

(a) The portion of the allowance allocated to these types of loans decreased in recent periods due to lower principal balances for these loan types.

(b) The portion of our allowance allocated to these types of loans increased in recent because of deterioration of the macro economy, devaluation of real estate and/or impaired ability of our borrowers to repay their obligations.

Allowance for Credit Losses; Impact on Earnings.

We have established the allowance for credit losses to cover for estimated losses inherent to the loans and lease portfolio at December 31, 2010. The allowance for credit losses is an estimate based upon several judgmental factors. We are not aware of known trends, commitments or other events that could reasonably occur that would materially affect our methodology or the assumptions used to estimate the allowance for credit losses. However, changes in qualitative and quantitative factors could occur at any time and such changes could be of a material nature. In addition, economic situations change, financial conditions of borrowers morph and other factors we consider in arriving at our estimates may evolve. To the extent that these matters have negative developments, our future earnings could be reduced by high provisions for credit losses.

Nonperforming Loans and Assets

The following table sets forth nonperforming assets, the allowance for credit losses and certain related ratios (dollars are in thousands):

	December 31,				
	2010	2009	2008	2007	2006
Nonperforming loans:					
Loans 90 days or more delinquent and still accruing interest	$ -	$ 1	$ 6	$ -	$ 2
Non-accrual loans	17,862	35,889	22,909	5,399	100
Total nonperforming loans	17,862	35,890	22,915	5,399	102
Other real estate, net	12,706	7,253	10,189	-	-
Total nonperforming assets	$ 30,568	$ 43,143	$ 33,104	$ 5,399	$ 102
Allowance for credit losses	$ 14,765	$ 18,047	$ 8,751	$ 6,599	$ 3,370
Ratio of total nonperforming loans to total loans	3.93%	6.19%	3.92%	1.03%	0.03%
Ratio of total nonperforming loans to loans and leases held for investment	5.10%	6.94%	4.22%	1.09%	0.03%
Ratio of total nonperforming assets to total assets	4.09%	4.97%	3.84%	0.77%	0.02%
Ratio of allowance for credit losses to total nonperforming loans(1)	92%	50%	38%	122%	3,304%
Ratio of allowance for credit losses to total nonperforming loans(2)	83%	-	-	-	-

(1) Excluding impact of pending sale

(2) Including impact of pending sale

Nonperforming Loans

The following table sets forth information concerning our nonperforming loans as of December 31 (dollars are in thousands):

	2010	2009
Balance, beginning of period	$ 35,890	$ 23,225
Additions to nonperforming	7,385	31,268
Charge-offs	(3,991)	(8,421)
Reclassified back to performing	(5,208)	(301)
Principal payments received	(4,882)	(1,749)
Transferred to other real estate owned	(11,332)	(8,132)
Balance, end of period	$ 17,862	$ 35,890

Past Due, Non-accrual and Restructured Loans

The following table indicates the effect on income if interest on non-accrual and restructured loans outstanding at year end had been recognized at original contractual rates during the year ended December 31 (in thousands):

	2010	2009
Interest income that would have been recorded	$ 1,601	$ 1,827
Interest income recorded	427	23
Effect on interest income	$ 1,174	$ 1,804

Loans 90 days or more delinquent and still accruing interest include loans over 90 days past due which we believe, based on our specific analysis of the loans, do not present doubt about the collection of interest and

principal in accordance with the loan contract. Loans in this category must be well secured and in the process of collection.

Non-accrual loans include loans on which the accrual of interest has been discontinued. Accrual of interest is discontinued when we believe that the borrower's financial condition is such that the collection of interest is doubtful. A delinquent loan is generally placed on non-accrual status when it becomes 90 days or more past due unless the loan is well secured and in the process of collection. When a loan is placed on non-accrual status, accrued but uncollected interest income applicable to the current reporting period is reversed against interest income. Accrued but uncollected interest income applicable to previous reporting periods is charged against the allowance for credit losses. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain.

Restructured loans are loans for which concessions, including a reduced interest rate or a deferral of interest or principal, have been granted due to the borrower's weakened financial condition. Once a loan is restructured, interest is accrued at the restructured rates when no loss of principal is anticipated. A loan that has performed in accordance with restructured terms for one year is no longer reported as a restructured loan.

The table below summarizes the amounts of restructured loans as of December 31 (in thousands):

Restructured Loans

	Total	Accrual	Non-accrual
2010	$ 34,264	$ 17,390	$ 16,874
2009	14,337	1,291	13,046
2008	2,379	-	2,379
2007	2,585	-	2,585
2006	54	-	54

Other real estate owned and repossessed assets represent properties and other assets acquired through, or in lieu of, loan foreclosure. They are initially recorded at fair value less cost to sell at the date of acquisition establishing a new cost basis. Write-downs to fair value at the time of acquisition are charged to the allowance for credit losses. After foreclosure, we perform valuations periodically and the real estate is recorded at fair value less cost to sell. Reductions to other real estate owned and repossessed assets are considered valuation allowances. Expenses incurred to record valuation allowances subsequent to foreclosure are charged to non-interest expense.

See Note 10 of our Consolidated Financial Statements for information on other real estate owned.

Impaired loans

See Note 8 of our Consolidated Financial Statements for information on impaired loans.

Potential Problem Loans

The macro economic environment is very challenging and asset values are declining throughout most of the country. So long as these conditions persist, many loans are potentially problematic assets.

Notwithstanding the prior paragraph, we attempt to quantify potential problem loans with more immediate credit risk. We estimate such loans totaled $12.4 million and $22.0 million at December 31, 2010 and 2009, respectively.

A significant portion of these potential problem loans are not in default but may have characteristics such as recent adverse operating cash flows or general risk characteristics that the loan officer feels might jeopardize the future timely collection of principal and interest payments. The ultimate resolution of these credits is subject to changes in economic conditions and other factors. These loans are closely monitored to ensure that our position as creditor is protected to the fullest extent possible.

Liabilities and Stockholders' Equity

The following table presents our liabilities and stockholders' equity (dollars are in thousands):

	As of December 31,		Increase (Decrease) 2010 – 2009		
	2010	2009	$	%	
Deposits:					
Non-interest-bearing	$ 91,478	$ 98,658	$ (7,180)	(7) %	(a)
Interest-bearing-					
Savings, interest checking and money market	243,332	280,571	(37,239)	(13) %	(a)
Time deposits $100,000 and over	39,580	52,222	(12,642)	(24) %	(b)
Other time deposits	179,275	324,512	(145,237)	(45) %	(b)
Non-interest-bearing held for sale	34,610	-	34,610	100 %	
Interest-bearing held for sale	72,836	-	72,836	100 %	
Short-term borrowings	16,329	10,190	6,139	60 %	(c)
FHLB advances	-	15,000	(15,000)	(100) %	(d)
Other borrowings	-	-	-	- %	
Guaranteed preferred beneficial interests in Company's subordinated debentures	24,134	22,890	1,244	5 %	
Accrued interest payable	852	1,468	(616)	(42) %	
Accrued expenses	4,704	2,946	1,758	60 %	(e)
Other liabilities	2,618	2,361	257	11 %	
Total liabilities	709,748	810,818	(101,070)	(12) %	
Stockholders' equity	37,321	57,265	(19,944)	(35) %	
Total liabilities and stockholders' equity	$ 747,069	$ 868,083	$ (121,014)	(14) %	

(a) These deposits decreased due to pending sale of certain deposits. See Note 3 of our Consolidated Financial Statements. These types of accounts fluctuate daily due to the cash management activities of our customers.

(b) We have lowered rates paid on certificates of deposits in order to reduce the size of our balance sheet.

(c) Short-term borrowings are primarily customer repurchase agreements. These balances can vary significantly depending on customer preferences.

(d) FHLB advances have decreased as the growth in deposits has been used to reduce borrowings.

(e) In 2010, we suspended payment on our dividends to preferred stockholders. Approximately $1.1 million of this increase relates to dividends accrued and not paid.

Deposits

The following table sets forth, for the periods indicated, the distribution of our average deposit account balances and average cost of funds rates on each category of deposits (dollars are in thousands):

Average Deposits and Deposits Costs

	For the Years Ended December 31,								
	2010			2009			2008		
	Average balance	Percent of deposits	Wgtd. avg. rate	Average balance	Percent of deposits	Wgtd. avg. rate	Average balance	Percent of deposits	Wgtd. avg. rate
Interest checking and MMDAs	$ 282,880	40.55%	0.61%	$ 266,537	36.60%	0.89%	$ 244,279	39.96%	1.67%
Savings deposits	11,156	1.60%	0.10%	11,685	1.61%	0.11%	9,859	1.61%	0.33%
Time deposits (CDs):									
CDs under $100,000	241,036	34.55%	2.52%	324,902	44.62%	2.66%	232,367	38.01%	3.87%
CDs $100,000 and over	45,083	6.46%	2.21%	47,358	6.50%	2.83%	58,378	9.55%	3.44%
Total time deposits	286,119	41.01%	2.47%	372,260	51.12%	2.68%	290,745	47.56%	3.78%
Total interest-bearing deposits	580,155	83.16%	1.52%	650,482	89.33%	1.90%	544,883	89.14%	2.77%
Non-interest-bearing demand deposits	117,459	16.84%	-	77,736	10.67%	-	66,388	10.86%	-
Total deposits	$ 697,614	100.00%	1.26%	$ 728,218	100.00%	1.70%	$ 611,271	100.00%	2.47%

Time deposits, in denominations of $100,000 and over, totaled $39.6 million at December 31, 2010 as compared to $52.2 million at December 31, 2009. The following table sets forth the amount and maturities of time deposits of $100,000 and over as of December 31, 2010 (in thousands):

Time Deposits of $100,000 and Over

Maturing in:	Time Deposits	Deposits Held for Sale	Time Deposits, net
3 months or less	$ 8,387	$ 1,463	$ 6,924
Over 3 months through 6 months	8,523	140	8,383
Over 6 months through 12 months	18,193	2,274	15,919
Over 12 months	9,312	958	8,354
	$ 44,415	$ 4,835	$ 39,580

Borrowed Funds

The following table provides a summary of our short-term borrowings and related cost information as of, or for the years ended, December 31 (dollars are in thousands):

Short-Term Borrowings

	2010	2009	2008
Short-term borrowings outstanding at period end	$ 16,329	$ 10,190	$ 16,844
Weighted average interest rate at period end	0.48%	0.70%	0.88%
Maximum month end balance during the period	$ 16,329	$ 23,818	$ 16,844
Average borrowings outstanding for the period	$ 11,163	$ 17,953	$ 7,049
Weighted average interest rate for the period	0.65%	1.00%	2.04%

Note 13 of our Consolidated Financial Statements summarizes the general terms of our short-term borrowings outstanding at December 31, 2010 and 2009.

FHLB advances totaled $0 million and $15.0 million at December 31, 2010 and 2009, respectively, while long-term borrowings totaled $0, for the same periods.

Notes 14 and 15 of our Consolidated Financial Statements summarize the general terms of our FHLB advances and other borrowings at December 31, 2010 and 2009.

Guaranteed Preferred Beneficial Interests in Company's Subordinated Debentures
See Note 16 of our Consolidated Financial Statements for a description of the subordinated debentures.

Capital Resources and Expenditures

	2010	2009	2008	2007	2006
Tier 1 leverage (Consolidated)	6.17%	8.58%	9.01%	12.01%	7.12%
Tier 1 risk-based capital (Consolidated)	9.49%	12.32%	11.15%	12.58%	9.49%
Total risk-based capital (Consolidated)	13.28%	14.15%	12.95%	14.26%	10.89%
Tangible common equity (Consolidated)	2.24%	4.23%	6.21%	8.47%	3.72%
Tier 1 leverage (BNC National Bank)	7.53%	8.54%	9.34%	12.57%	7.70%
Tier 1 risk-based capital (BNC National Bank)	11.57%	12.25%	11.56%	13.18%	10.26%
Total risk-based capital (BNC National Bank)	12.85%	13.52%	12.81%	14.26%	10.94%

See Note 2 of our Consolidated Financial Statements for a discussion of regulatory capital and the current operating environment.

Off-Balance-Sheet Arrangements

In the normal course of business, we are a party to various financial instruments with off-balance-sheet risk. These instruments include commitments to extend credit, commercial letters of credit, performance and financial standby letters of credit and interest rate swaps, caps and floors. Such instruments help us to meet the needs of our customers, manage our interest rate risk and effectuate various transactions. These instruments and commitments, which we enter into for purposes other than trading, carry varying degrees of credit, interest rate or liquidity risk. See Notes 21 and 22 of our Consolidated Financial Statements for a detailed description of each of these instruments.

Contractual Obligations, Contingent Liabilities and Commitments
We are a party to financial instruments with risks that can be subdivided into two categories:

Cash financial instruments, generally characterized as on-balance-sheet items, include investments, loans, mortgage-backed securities, deposits and debt obligations.

Credit-related financial instruments, generally characterized as off-balance-sheet items, include such instruments as commitments to extend credit, commercial letters of credit and performance and financial standby letters of credit. See Note 21 of our Consolidated Financial Statements.

At December 31, 2010, the aggregate contractual obligations (excluding bank deposits) and commitments were as follows (in thousands):

Contractual Obligations:	Payments due by period				
	Less than 1 year	1 to 3 years	3 to 5 years	After 5 years	Total
Total borrowings	$ 16,329	$ -	$ -	$ 24,134	$ 40,463
Commitments to sell loans	28,734	-	-	-	28,734
Annual rental commitments under non-cancelable operating leases	665	385	285	1,822	3,157
Total	$ 45,728	$ 385	$ 285	$ 25,956	$ 72,354

Other Commitments:	Amount of Commitment - Expiration by Period				
	Less than 1 year	1 to 3 years	3 to 5 years	After 5 years	Total
Commitments to lend	$ 90,225	$ 3,918	$ 2,496	$ 544	$ 97,183
Standby and commercial letters of credit	2,394	1,335	-	-	3,729
Total	$ 92,619	$ 5,253	$ 2,496	$ 544	$ 100,912

Liquidity Risk Management

Liquidity risk is the possibility of being unable to meet financial obligations in a timely manner. The objectives of liquidity management policies are to maintain adequate liquid assets and diversified liabilities. Diversification is provided by varying debt instruments, maturities and counterparties.

The Consolidated Statements of Cash Flows in the Consolidated Financial Statements present data on cash and cash equivalents provided by and used in operating, investing and financing activities. We obtain funding and liquidity through repayments and sales of assets. In addition, we obtain liquidity and funding from core deposits, brokered deposits, repurchase agreements and overnight Federal funds. The Bank is a member of the FHLB of Des Moines, which provides an opportunity to borrow funds. We have also obtained funding through the issuance of subordinated notes, subordinated debentures and long-term borrowings.

We assess liquidity by our ability to raise cash when we need it at a reasonable cost and with a minimum of loss of income. Given the uncertain nature of our customers' demands, as well as our desire to take advantage of earnings enhancement opportunities, we must have adequate sources of on- and off-balance-sheet funds that can be accessed as needed.

We measure our liquidity position on a monthly basis. Key factors that determine our liquidity are the reliability or stability of our deposit base, the pledged/non-pledged status of our investments and potential loan demand. Our liquidity management system divides the balance sheet into liquid assets and short-term liabilities that are assumed to be vulnerable to non-replacement under abnormally stringent conditions. The excess of liquid assets over short-term liabilities is measured over a 30-day planning horizon. Assumptions for short-term liabilities vulnerable to non-replacement under abnormally stringent conditions are based on a historical analysis of the month-to-month percentage changes in deposits. In addition, we subject these assumptions to stress tests to measure the degree of volatility our liquidity position could manage over the 30-day horizon. The excess of liquid assets over short-term liabilities and other key factors such as expected loan demand as well as access to other sources of liquidity such as lines with the FHLB, Federal funds and those other supplemental sources listed above are tied together to provide a measure of our liquidity. We also manage for anticipated future funding needs and liquidity risk by projecting sources and uses of funds under normal as well as stressed environments. We have a targeted range of liquidity metrics and manage our operations such that these targets can be achieved. We believe

our policies and guidelines will provide for adequate levels of liquidity to fund anticipated needs of on- and off-balance-sheet items. In addition, a contingency funding policy statement identifies actions to be taken in response to an adverse liquidity event.

Available borrowing capacity from the FHLB was approximately $76.1 million as of December 31, 2010. See Note 14 of our Consolidated Financial Statements.

Forward-Looking Statements

Statements included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" which are not historical in nature are intended to be, and are hereby identified as "forward-looking statements" for purposes of the safe harbor provided by Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We caution readers that these forward-looking statements, including without limitation, those relating to our future business prospects, revenues, working capital, liquidity, capital needs, interest costs, income and expenses, are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements due to several important factors. These factors include, but are not limited to: risks of loans and investments, including dependence on local and regional economic conditions; competition for our customers from other providers of financial services; possible adverse effects of changes in interest rates including the effects of such changes on derivative contracts and associated accounting consequences; risks associated with our acquisition and growth strategies; and other risks which are difficult to predict and many of which are beyond our control.

Recently Issued and Adopted Accounting Pronouncements

Note 1 of our Consolidated Financial Statements includes a summary of recently issued and adopted accounting pronouncements and their related or anticipated impact on the Company.

Critical Accounting Policies

Note 1 of our Consolidated Financial Statements includes a summary of our critical accounting policies and their related impact on the Company.

Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the possibility that changes in future market rates or prices will have a negative impact on our earnings or value. Our principal market risk is interest rate risk.

Interest rate risk arises from changes in interest rates. Interest rate risk can result from: (1) Repricing risk – timing differences in the maturity/repricing of assets, liabilities, and off-balance-sheet contracts; (2) Options risk – the effect of embedded options, such as loan prepayments, interest rate caps/floors, and deposit withdrawals; (3) Basis risk – risk resulting from unexpected changes in rates of similar maturity; and (4) Yield curve risk – risk resulting from unexpected changes in rates of different maturities from the same type of instrument. We have risk management policies to monitor and limit exposure to interest rate risk. Historically, we have not conducted trading activities as a means of managing interest rate risk. Our asset/liability management process is utilized to manage our interest rate risk.

Our interest rate risk exposure is managed with the objective of managing the level and potential volatility of net interest income, bearing in mind that we are in the business of taking rate risk and that rate risk immunization is not entirely possible. Also, it is recognized that as exposure to interest rate risk is reduced, so too may the overall level of net interest income. In general, the assets and liabilities generated through ordinary business activities do not naturally create offsetting positions with respect to repricing or maturity characteristics. Access to the derivatives market can be an element in maintaining our interest rate risk position within policy guidelines. Using derivative instruments, principally interest rate floors, caps, and interest rate swaps, the interest rate sensitivity of specific transactions, as well as pools of assets or liabilities, can be adjusted to maintain the desired interest rate risk profile. See Notes 1 and 18 of our Consolidated Financial Statements for a summary of our accounting policies pertaining to such instruments.

Our primary tool for measuring and managing interest rate risk is net interest income simulation. This exercise includes our assumptions regarding the changes in interest rates and the impact on our current balance sheet. Interest rate caps and floors are included to the extent that they are exercised in the 12-month simulation period. Additionally, changes in prepayment behavior of the residential mortgage, CMOs, and mortgage-backed securities portfolios in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. For purposes of this simulation, projected month end balances of the various balance sheet accounts are held constant at their December 31, 2010 levels. Cash flows from a given account are reinvested back into the same account so as to keep the month end balance constant at its December 31, 2010 level. The static balance sheet assumption is made so as to project the interest rate risk to net interest income embedded in the existing balance sheet.

We monitor the results of net interest income simulation on a quarterly basis. Each quarter net interest income is generally simulated for the upcoming 12-month horizon in seven interest scenarios. The scenarios generally modeled are parallel interest ramps of +/- 100bp, 200bp, and 300bp along with a rates unchanged scenario. Given the low level of interest rates as of December 31, 2010, the downward scenarios for interest rate movements is limited to -100bp, but a + 400bp scenario was also measured. The parallel movement of interest rates means all projected market interest rates move up or down by the same amount. A ramp in interest rates means that the projected change in market interest rates occurs over the 12-month horizon on a pro-rata basis. For example, in the +100bp scenario, the projected prime rate is projected to increase from 3.25% to 4.25% 12 months later. The prime rate in this example will increase 1/12th of the overall decrease of 100 basis points each month.

The net interest income simulation result for the 12-month horizon that covers the calendar year of 2010 is shown below:

Net Interest Income Simulation

Movement in interest rates	-100bp	Unchanged	+100bp	+200bp	+300bp	+400bp
Projected 12-month net interest income	$ 22,327	$ 22,292	$ 23,028	$ 23,549	$ 23,808	$ 23,992
Dollar change from unchanged scenario	$ 35	-	$ 736	$ 1,257	$ 1,516	$ 1,700
Percentage change from unchanged scenario	0.16%	-	3.30%	5.64%	6.80%	7.63%

Because one of the objectives of asset/liability management is to manage net interest income over a one-year planning horizon, policy guidelines are stated in terms of maximum potential percentage reduction in net interest income resulting from changes in interest rates over the 12-month period. It is no less important, however, to give attention to the absolute dollar level of projected net interest income over the 12-month period.

Our general policy is to limit the percentage decrease in projected net interest income to 5, 10, 15, and 20 percent from the rates unchanged scenario for the +/- 100bp, 200bp, 300bp, and 400bp interest rate ramp scenarios, respectively. When a given scenario falls outside of these limits, we review the circumstances surrounding the exception and, considering the level of net interest income generated in the scenario and other related factors, may approve the exception to the general policy or recommend actions aimed at bringing the respective scenario within the general limits noted above.

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of December 31, 2010 (without forward adjustments for planned growth and anticipated business activities) and do not contemplate any actions we might undertake in response to changes in market interest rates.
The pending divestiture discussed in Note 3 of our Consolidated Financial Statements is expected to reduce net interest income, but interest rate sensitivity after the pending divestiture is expected to be similar to the table presented above.

Static gap analysis is another tool that may be used for interest rate risk measurement. The net differences between the amount of assets, liabilities, equity and off-balance-sheet instruments repricing within a cumulative calendar period is typically referred to as the "rate sensitivity position" or "gap position." The following table sets forth our rate sensitivity position as of December 31, 2010. Assets and liabilities are classified by the earliest possible repricing date or maturity, whichever occurs first.

Interest Sensitivity Gap Analysis

	Estimated maturity or repricing at December 31, 2010				
	0–3 months	4–12 months	1–5 years	Over 5 years	Total
	(dollars are in thousands)				
Interest-earning assets:					
Interest-bearing deposits with banks	$ 112,847	$ -	$ -	$ -	$ 112,847
Investment securities	12,864	32,433	51,806	39,929	137,032
FRB and FHLB stock	2,862	-	-	-	2,862
Fed Funds Sold	-	-	-	-	-
Loans held for sale-mortgage banking, fixed rate	-	29,116	-	-	29,116
Loans held for sale-mortgage banking, floating rate	-	-	-	-	-
Other loans held for sale, fixed rate	73	3,776	29,348	4,599	37,796
Other loans held for sale, floating rate	28,202	637	3,866	-	32,705
Loans held for investment, fixed rate	37,828	49,289	71,235	10,692	169,044
Loans held for investment, floating rate	171,414	1,500	13,431	-	186,345
Total interest-earning assets	$ 366,090	$ 116,751	$ 169,686	$ 55,220	$ 707,747
Interest-bearing liabilities:					
Interest checking and money market accounts	$ 232,586	$ -	$ -	$ -	$ 232,586
Interest checking and money market accounts held for sale	46,798	-	-	-	46,798
Savings	11,709	-	-	-	11,709
Savings held for sale	963	-	-	-	963
Time deposits under $100,000	30,233	60,421	38,319	50,302	179,275
Time deposits $100,000 and over	4,510	25,759	9,311	-	39,580
Time deposits under $100,000 held for sale	17,577	2,611	52	-	20,240
Time deposits $100,000 and over held for sale	3,877	958	-	-	4,835
Short-term borrowings	16,329	-	-	-	16,329
FHLB advances	-	-	-	-	-
Other borrowings	-	-	-	-	-
Subordinated debentures	15,000	-	-	9,134	24,134
Total interest-bearing liabilities	$ 379,582	$ 89,749	$ 47,682	$ 59,436	$ 576,449
Interest rate gap	$ (13,492)	$ 27,002	$ 122,004	$ (4,216)	$ 131,298
Cumulative interest rate gap at December 31, 2010	$ (13,492)	$ 13,510	$ 135,514	$ 131,298	
Cumulative interest rate gap to total assets	(1.81%)	1.81%	18.14%	17.58%	

The table assumes that all savings and interest-bearing demand deposits reprice in the earliest period presented. However, we believe a significant portion of these accounts constitute a core component and are generally not rate sensitive. Our position is supported by the fact that aggressive reductions in interest rates paid on these deposits historically have not caused notable reductions in balances in net interest income because the repricing of certain assets and liabilities is discretionary and is subject to competitive and other pressures. As a result, assets and liabilities indicated as repricing within the same period may in fact reprice at different times and at different rate levels.

Static gap analysis does not fully capture the impact of embedded options, lagged interest rate changes, administered interest rate products, or certain off-balance-sheet sensitivities to interest rate movements. Therefore, this tool generally cannot be used in isolation to determine the level of interest rate risk exposure in banking institutions.

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of December 31, 2010 and do not contemplate any actions we might undertake in response to changes in market interest rates.

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Independent Auditors' Report

The Board of Directors and Stockholders
BNCCORP, INC.:

We have audited the accompanying consolidated balance sheets of BNCCORP, INC. and subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BNCCORP, INC. and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

Omaha, Nebraska
March 22, 2011

KPMG LLP is a Delaware limited liability partnership, the U.S. member firm of KPMG International Cooperative ("KPMG International"), a Swiss entity.

FINANCIAL INFORMATION

Financial Statements

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
As of December 31
(In thousands, except share data)

ASSETS	2010	2009
CASH AND CASH EQUIVALENTS	$ 112,847	$ 35,362
INVESTMENT SECURITIES AVAILABLE FOR SALE	137,032	212,661
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	2,862	3,048
LOANS HELD FOR SALE-MORTGAGE BANKING	29,116	24,130
PARTICIPATING INTERESTS IN MORTGAGE LOANS	4,888	38,534
LOANS AND LEASES HELD FOR INVESTMENT	350,501	517,108
ALLOWANCE FOR CREDIT LOSSES	(14,765)	(18,047)
Net loans and leases held for investment	340,624	537,595
OTHER LOANS HELD FOR SALE, net	70,501	-
OTHER REAL ESTATE, net	12,706	7,253
PREMISES AND EQUIPMENT, net	16,684	20,422
INTEREST RECEIVABLE	2,138	2,970
OTHER ASSETS	19,790	24,642
PREMISES AND EQUIPMENT HELD FOR SALE, net	2,769	-
Total assets	$ 747,069	$ 868,083
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	$ 91,478	$ 98,658
Interest-bearing –		
Savings, interest checking and money market	243,332	280,571
Time deposits $100,000 and over	39,580	52,222
Other time deposits	179,275	324,512
Non-interest-bearing held for sale	34,610	-
Interest-bearing held for sale	72,836	-
Total deposits	661,111	755,963
SHORT-TERM BORROWINGS	16,329	10,190
FEDERAL HOME LOAN BANK ADVANCES	-	15,000
OTHER BORROWINGS	-	-
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	24,134	22,890
ACCRUED INTEREST PAYABLE	852	1,468
ACCRUED EXPENSES	4,704	2,946
OTHER LIABILITIES	2,618	2,361
Total liabilities	709,748	810,818
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par value – Authorized 2,000,000 shares:		
Preferred Stock - 5% Series A 20,093 shares outstanding;	19,411	19,187
Preferred Stock - 9% Series B 1,005 shares outstanding;	1,075	1,098
Common stock, $.01 par value – Authorized 35,000,000 shares; 3,304,339 and 3,290,219 shares issued and outstanding	33	33
Capital surplus – common stock	27,036	26,885
Retained earnings (deficit)	(7,322)	16,078
Treasury stock (364,314 and 363,434 shares, respectively)	(5,069)	(5,068)
Accumulated other comprehensive gain (loss), net	2,157	(948)
Total stockholders' equity	37,321	57,265
Total liabilities and stockholders' equity	$ 747,069	$ 868,083

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
For the Years Ended December 31
(In thousands, except per share data)

	2010	2009
INTEREST INCOME:		
Interest and fees on loans	$ 24,675	$ 29,774
Interest and dividends on investments -		
Taxable	8,613	14,261
Tax-exempt	93	409
Dividends	129	144
Total interest income	33,510	44,588
INTEREST EXPENSE:		
Deposits	8,808	12,386
Short-term borrowings	73	179
Federal Home Loan Bank advances	113	1,078
Other borrowings	-	3
Subordinated debentures	1,244	1,253
Total interest expense	10,238	14,899
Net interest income	23,272	29,689
PROVISION FOR CREDIT LOSSES	5,750	27,000
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	17,522	2,689
NON-INTEREST INCOME:		
Bank charges and service fees	2,533	2,332
Wealth management revenues	2,133	2,056
Mortgage banking revenues	13,424	8,390
Gains (losses) on sales of loans, net	371	(339)
Gain on sales of securities, net	4,390	2,850
Other	1,122	724
Total non-interest income	23,973	16,013
NON-INTEREST EXPENSE:		
Salaries and employee benefits	16,080	15,008
Professional services	5,068	3,064
Other real estate costs	2,707	8,169
Occupancy	2,885	2,508
Data processing fees	2,697	2,330
Regulatory costs	1,951	1,466
Marketing and promotion	1,372	1,277
Depreciation and amortization	1,333	1,465
Office supplies and postage	603	611
Fraud loss on assets serviced by others	26,231	-
Other	2,561	3,205
Total non-interest expense	63,488	39,103
Loss before income taxes	(21,993)	(20,401)
Income tax expense (benefit)	72	(1,625)
NET LOSS	$ (22,065)	$ (18,776)
Preferred stock costs	(1,333)	(1,254)
Net loss available to common shareholders	$ (23,398)	$ (20,030)
Basic loss per common share	$ (7.13)	$ (6.14)
Diluted loss per common share	$ (7.13)	$ (6.14)

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Loss)

For the Years Ended December 31

(In thousands)

	2010		2009	
NET LOSS		$ (22,065)		$ (18,776)
Unrealized gain (loss) on cash flow hedge, net	$ -		$ (375)	
Amortization of deferred gain in other comprehensive income	(40)		(1,126)	
Unrealized gain on securities available for sale	7,535		10,299	
Reclassification adjustment for gains included in net income	(4,390)		(2,850)	
Other comprehensive income, before tax	3,105		5,948	
Income tax (expense) benefit related to items of other comprehensive income	-		(3,098)	
Other comprehensive income	3,105	3,105	2,850	2,850
TOTAL COMPREHENSIVE LOSS		$ (18,960)		$ (15,926)

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

For the Years Ended December 31

(In thousands)

	Preferred Stock		Common Stock		Capital Surplus Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount	Shares	Amount					
BALANCE, December 31, 2008	-	$ -	3,299,163	$ 33	$ 26,628	$ 36,104	$ (5,020)	$ (3,798)	$ 53,947
Net loss	-	-	-	-	-	(18,776)	-	-	(18,776)
Other comprehensive income	-	-	-	-	-	-	-	2,850	2,850
Preferred stock issued	21,098	21,098	-	-	-	-	-	-	21,098
Discount on preferred stock, net	-	(1,005)	-	-	-	-	-	-	(1,005)
Preferred stock amortization, net	-	192	-	-	-	(192)	-	-	-
Dividend on preferred stock	-	-	-	-	-	(1,058)	-	-	(1,058)
Impact of share-based compensation	-	-	(8,944)	-	257	-	(48)	-	209
BALANCE, December 31, 2009	21,098	$ 20,285	3,290,219	$ 33	$ 26,885	$ 16,078	$ (5,068)	$ (948)	$ 57,265
Net loss	-	-	-	-	-	(22,065)	-	-	(22,065)
Other comprehensive income	-	-	-	-	-	-	-	3,105	3,105
Preferred stock amortization, net	-	201	-	-	-	(201)	-	-	-
Dividend on preferred stock	-	-	-	-	-	(1,134)	-	-	(1,134)
Impact of share-based compensation	-	-	14,120	-	151	-	(1)	-	150
BALANCE, December 31, 2010	21,098	$ 20,486	3,304,339	$ 33	$ 27,036	$ (7,322)	$ (5,069)	$ 2,157	$ 37,321

See accompanying notes to consolidated financial statements

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Years Ended December 31 (In thousands)

	2010	2009
OPERATING ACTIVITIES:		
Net loss	$ (22,065)	$ (18,776)
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision for credit losses	5,750	27,000
Provision for other real estate losses	2,383	8,057
Depreciation and amortization	1,333	1,465
Net amortization of premiums and (discounts) on investment securities and subordinated debentures	(269)	(2,836)
Share-based compensation	150	257
Change in interest receivable and other assets, net	7,123	(5,656)
Impairment of goodwill	-	409
Loss on disposals of bank premises and equipment, net	28	-
Fraud loss on assets serviced by others	26,231	-
Loss on sale of other real estate	126	(1)
Bank premises and equipment, net charges associated with branch closure	103	-
Gain on sale of branch	(403)	-
Net realized gain on sales of investment securities	(4,390)	(2,850)
Provision (benefit) for deferred income taxes	(1,243)	2,473
Change in other liabilities, net	986	(1,532)
(Gains) losses on sale of loans, net	(371)	339
Proceeds from sales of loans	4,264	10,565
Originations of loans held for sale	(662,095)	(491,027)
Proceeds from sales of loans held for sale	656,844	480,279
Fair value adjustment for loans held for sale	265	21
Net cash provided by operating activities	14,750	8,187
INVESTING ACTIVITIES:		
Purchases of investment securities	(49,946)	(138,560)
Proceeds from sales of investment securities	84,450	71,553
Proceeds from maturities of investment securities	49,620	76,021
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(556)	-
Sales of Federal Reserve and Federal Home Loan Bank Stock	742	2,941
Net decrease (increase) in participating interests in mortgage loans	7,415	(9,950)
Net decrease (increase) in loans held for investment	71,848	(11,094)
Proceeds from sales of other real estate	3,370	3,012
Additions to bank premises and equipment	(604)	(1,091)
Proceeds from sales of bank premises and equipment	109	13
Net cash provided by (used in) investing activities	166,448	(7,155)

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows, continued
For the Years Ended December 31 (In thousands)

	2010	2009
FINANCING ACTIVITIES:		
Net (decrease) increase in deposits	(94,852)	80,643
Net increase (decrease) in short-term borrowings	6,139	(6,654)
Repayments of Federal Home Loan Bank advances	(20,000)	(1,087,300)
Proceeds from Federal Home Loan Bank advances	5,000	1,017,800
Proceeds from issuance of preferred stock	-	20,093
Dividends paid on preferred stock	-	(821)
Net cash (used in) provided by financing activities	(103,713)	23,761
NET INCREASE IN CASH AND CASH EQUIVALENTS	77,485	24,793
CASH AND CASH EQUIVALENTS, beginning of year	35,362	10,569
CASH AND CASH EQUIVALENTS, end of year	$ 112,847	$ 35,362
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 10,855	$ 15,110
Income taxes paid (received)	$ (6,166)	$ 2,498
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to other real estate in settlement of loans	$ 11,332	$ 8,132
Transfer of net loans held for investment to loans held for sale	$ 70,501	$ -
Transfer of premises and equipment to premises and equipment held for sale	$ 2,769	$ -
Transfer of non-interest bearing deposits to non-interest bearing deposits held for sale	$ 34,610	$ -
Transfer of interest bearing deposits to interest bearing deposits held for sale	$ 72,836	$ -

See accompanying notes to consolidated financial statements.

NOTE 1. Description of Business and Significant Accounting Policies

Description of Business

BNCCORP, INC. (BNCCORP) is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (together with its wholly owned subsidiary, BNC Insurance Services, Inc., collectively the Bank). The Company operates community banking and wealth management businesses in Arizona, Minnesota and North Dakota from 18 locations. The Bank also conducts mortgage banking from 10 locations in Arizona, Minnesota, Iowa, Kansas, Nebraska and Missouri.

The consolidated financial statements included herein are for BNCCORP and its subsidiaries. The accounting and reporting policies of BNCCORP and its subsidiaries (collectively, the Company) conform to U.S. generally accepted accounting principles and general practices within the financial services industry. The more significant accounting policies are summarized below.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of BNCCORP and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the useful lives of premises and equipment, allowance for credit losses, valuation of other real estate, income taxes and valuation and impairment of investment securities. Ultimate results could differ from those estimates.

CRITICAL ACCOUNTING POLICIES

Critical accounting policies are significantly dependent on subjective assessments or estimates that may be susceptible to significant change. The following items have been identified as “critical accounting policies”.

Allowance for Credit Losses

The Bank maintains its allowance for credit losses at a level considered adequate to provide for probable losses related to the loan and lease portfolio as of the balance sheet dates. The loan and lease portfolio and other credit exposures are reviewed regularly to evaluate the adequacy of the allowance for credit losses.

The methodology used to establish the allowance for credit losses incorporates quantitative and qualitative risk considerations. Quantitative factors include our historical loss experience, delinquency information, charge-off trends, collateral values, changes in nonperforming loans and other factors. Quantitative factors also incorporate known information about individual borrowers, including sensitivity to interest rate movements or other quantifiable external factors.

Qualitative factors include the general economic environment, the state of certain industries and factors unique to our market areas. Size, complexity of individual credits, loan structure, waivers of loan policies and pace of portfolio growth are other qualitative factors that are considered when we estimate the allowance for credit losses.

Our methodology has been consistently applied. However, we enhance our methodology as circumstances dictate to keep pace with the complexity of the portfolio.

The allowance for credit losses has three components as follows:

Specific Reserves. The amount of specific reserves is determined through a loan-by-loan analysis of loans over a minimum size. Included in problem loans are non-accrual or renegotiated, loans that meet the impairment criteria in FASB ASC 310. A loan is impaired when, based on current information, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Any allowance on impaired loans is generally based on one of three methods: the present value of expected cash flows at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral of the loan. Specific reserves may also be established for credits that have been internally classified as credits requiring management's attention due to underlying problems in the borrower's business or collateral concerns.

Reserves for Homogeneous Loan Pools. The Bank makes a significant number of loans and leases that, due to their underlying similar characteristics, are assessed for loss as "homogeneous" pools. Included in the homogeneous pools are consumer loans and commercial loans, which have been excluded from the specific reserve allocation. The Bank segments the homogeneous pools by type and uses historical loss information to estimate a loss reserve for each pool.

Qualitative Reserve. Management also allocates reserves for other circumstances pertaining to the measurement period. The factors considered include, but are not limited to, prevailing trends, economic conditions, geographic influence, industry segments within the portfolio, management's assessment of credit risk inherent in the loan portfolio, delinquency data, historical loss experience and peer-group information.

Monitoring loans and analysis of loss components are the principal means by which management determines estimated credit losses are reflected in the Bank's allowance for credit losses on a timely basis. Management also considers regulatory guidance in addition to the Bank's own experience. Various regulatory agencies, as an integral part of their examination process, periodically review the allowance for credit losses. Such agencies may require additions to the allowance based on their judgment about information available to them at the time of their examination.

Loans, leases and other extensions of credit deemed uncollectible are charged off against the allowance for losses. Subsequent recoveries, if any, are credited to the allowance.

The allowance for credit losses is highly dependent upon variables affecting valuation, including appraisals of collateral, evaluations of performance as well as the amounts and timing of future cash flows expected to be received on impaired loans. These variables are reviewed periodically. Actual losses may vary from the current estimated allowance for credit losses. For nonperforming or impaired loans, appraisals are generally performed annually or whenever circumstances warrant a new appraisal. Management regularly evaluates the appraised value and costs to liquidate in order to estimate fair value. A provision for credit losses is made to adjust the allowance to the amount determined appropriate through application of the above processes.

Income Taxes

The Company files consolidated federal and unitary state income tax returns.

The determination of current and deferred income taxes is based on analyses of many factors including interpretation of federal and state income tax laws, differences between tax and financial reporting basis of assets and liabilities, expected reversals of temporary differences, estimates of amounts due or owed and current financial accounting standards. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income taxes.

Deferred income taxes are accounted for using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

Management assesses net deferred tax assets to determine whether they are realizable based upon accounting standards and specific facts and circumstances. A valuation allowance is established to reduce net deferred tax assets to amounts that are more likely than not expected to be realized.

Other-Than-Temporary Impairment

Declines in the fair value of individual available-for-sale or held-to-maturity securities below amortized cost, which are deemed other-than-temporary, could result in a charge to earnings and establishment of a new cost basis. Write-downs for other-than-temporary impairment are recorded in non-interest income as realized losses. The Company assesses available information about our securities to determine whether impairment is other-than-temporary. The information we consider includes, but is not limited to, the following:

- Recent and expected performance of the securities;
- Financial condition of issuers or guarantors;
- Recent cash flows;
- Seniority of invested tranches and subordinated credit support;
- Vintage of origination;
- Location of collateral;
- Ratings of securities;
- Value of underlying collateral;
- Delinquency and foreclosure data;
- Historical losses and estimated severity of future losses;
- Credit surveillance data which summarize retrospective performance; and
- Anticipated future cash flows and prospective performance assessments.

Determining whether other-than-temporary impairment has occurred requires judgment of factors that may indicate an impairment loss has incurred. The Company adopted the guidance on other-than-temporary impairments Accounting Standards Codification (ASC) 320, *Investments-Debt and Equity Securities*, which amended the accounting for other-than-temporary impairments into credit-related and other factors. Any credit-related impairments are realized through a charge to earnings. The amount of non-credit related impairments is recognized through comprehensive income, net of income taxes.

Note 6 to these consolidated financial statements includes a summary of investment securities in a loss position at December 31, 2010 and 2009.

Fair Value

Several accounting standards require recording assets and liabilities based on their fair values. Determining the fair value of assets and liabilities can be highly subjective. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market.

FASB ASC 820, *Fair Value Measurements and Disclosures* defines fair value and establishes a framework for measuring fair value of assets and liabilities using a hierarchy system consisting of three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets that the Company has the ability to access.

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 significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market and are used only to the extent that observable inputs are not available. These

unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability.

Management assigns a level to assets and liabilities accounted for at fair value and uses the methodologies prescribed by ASC 820 to determine fair value.

OTHER SIGNIFICANT ACCOUNTING POLICIES

Investment Securities
Investment securities that the Bank intends to hold indefinitely as part of its asset/liability strategy, or that may be sold in response to changes in interest rates or prepayment risk are classified as available for sale. Available for sale securities are carried at fair value. Net unrealized gains and losses, net of deferred income taxes, on securities available for sale are reported as a separate component of stockholders' equity until realized (see Comprehensive Income). All securities were classified as available for sale as of December 31, 2010 and 2009, except for Federal Reserve Bank (FRB) and the Federal Home Loan Bank (FHLB) stock, which have an indeterminable maturity.

Investment securities that the Bank intends to hold until maturity are carried at cost, adjusted for amortization of premiums and accretion of discounts using a level yield method over the period to maturity. There were no such securities as of December 31, 2010 or 2009.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the effective interest method. Dividend and interest income is recognized when earned. Realized gains and losses on the sale of investment securities are determined using the specific-identification method and recognized in non-interest income on the trade date.

Federal Reserve Bank and Federal Home Loan Bank of Des Moines Stock
Investments in FRB and FHLB stock are carried at cost, which approximates fair value.

Loans Held For Sale-Mortgage Banking
Loans held for sale-mortgage banking are accounted for at fair value pursuant to the fair value option permitted by FASB ASC 825, *Financial Instruments.* Gains and losses from the changes in fair value are included in mortgage banking revenue.

Participating Interests in Mortgage Loans
The Bank purchases participating interests in mortgage loans (i.e. we own the loans) from mortgage banking counterparties. The participating interests are generally outstanding for a short duration as funds are advanced to finance loans closed by the counterparties and are repaid when the counterparties sell the loans. The counterparties service BNC's assets while they are outstanding. The participating interests are stated at the aggregate amount of the loans financed by the counterparties. An allowance for losses is estimated on the participating interests and is included in the allowance for credit losses.

Loans and Leases
Loans and leases held for investment are stated at their outstanding principal amount net of unearned income, net of unamortized deferred fees and costs and an allowance for credit losses. Interest income is recognized on the accrual basis using the interest method prescribed in the loan agreement except when collectibility is in doubt.

Loans and leases are reviewed regularly by management and are placed on non-accrual status, when the collection of interest or principal is 90 days or more past due, unless the loan or lease is adequately secured and in the process of collection. When a loan or lease is placed on non-accrual status, uncollected interest accrued in prior years is charged off against the allowance for credit losses, unless collection of the principal and interest is assured. Interest accrued in the current year is reversed against interest income in the current period. Interest payments received on non-accrual loans and leases are generally applied to principal unless the remaining principal balance has been determined to be fully collectible. Accrual of interest may be resumed when it is determined that all amounts due are expected to be collected and the loan has exhibited a sustained level of performance, generally at least six months.

A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans are reviewed for impairment on an individual basis. Impaired loans are measured at the present value of expected future cash flows discounted at the loan's initial effective interest rate. The fair value of collateral of an impaired collateral-dependent loan or an observable market price may be used as an alternative to discounting cash flows. If the measure of the impaired loan is less than the recorded investment in the loan, impairment will be recognized as a charge-off through the allowance for credit losses.

Restructured loans are loans for which concessions, including a reduced interest rate or a deferral of interest or principal, have been granted due to the borrower's weakened financial condition. Once a loan is restructured, interest is accrued at the restructured rates when no loss of principal is anticipated. A loan that has performed in accordance with restructured terms for one year is no longer reported as a restructured loan.

Cash receipts on impaired loans are generally applied to principal except when the loan is well collateralized or there are other circumstances that support recognition of interest. When an impaired loan is in non-accrual status, cash receipts are applied to principal.

Loan Origination Fees and Costs; Other Lending Fees
For Loans and Leases Held for Investment, origination fees and costs incurred to extend credit are deferred and amortized over the term of the loan as an adjustment to yield using the interest method, except where the net amount is deemed to be immaterial.

The Company occasionally originates lines of credit where the customer is charged a non-usage fee if the line of credit is not used. In such instances, we periodically review use of lines on a retrospective basis and recognize non-usage fees in non-interest income.

Loan Servicing and Transfers of Financial Assets
The Bank sells commercial business loans to third parties. The loans are generally sold on a non-recourse basis. Sold loans are not included in the accompanying consolidated balance sheets. The Bank generally retains the right to service the loans as well as the right to receive a portion of the interest income on the loans.

The sales of loans are accounted for pursuant to FASB ASC 860, *Transfers and Servicing*.

Premises and Equipment
Land is carried at cost. Premises and equipment are reported at cost less accumulated depreciation and amortization. Depreciation and amortization for financial reporting purposes is charged to operating expense using the straight-line method over the estimated useful lives of the assets. Estimated useful lives are up to 40 years for buildings and three to 10 years for furniture and equipment. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the improvement. The costs of improvements are capitalized. Maintenance and repairs, as well as gains and losses on dispositions of premises and equipment, are included in non-interest income or expense as incurred.

Other Real Estate Owned and Repossessed Property
Real estate properties and other assets acquired through loan foreclosures are stated at the lower of carrying amount or fair value less estimated costs to sell. If the carrying amount of an asset acquired through foreclosure is in excess of the fair value less estimated costs to sell, the excess amount is charged to the allowance for credit losses. Fair value is primarily determined based upon appraisals of the assets involved and management periodically assesses appraised values to ascertain continued relevancy of the valuation. Subsequent declines in the estimated fair value, net operating results and gains and losses on disposition of the asset are included in other non-interest expense. Operating expenses of properties are charged to other real estate costs.

Impairment of Long-Lived Assets and Intangible Assets
The Company reviews long-lived assets and intangible assets for impairment periodically or whenever events or changes in circumstances indicate that the carrying amount of any such asset may not be recoverable. If impairment is identified, the assets are written down to their fair value through a charge to non-interest expense.

During the years ended December 31, 2010 and 2009, an impairment charge of $0 and $409 thousand, respectively was recorded related to goodwill.

Other Loans Held for Sale, Premises and Equipment Held for Sale and Deposits Held For Sale
Other loans held for sale, premises and equipment held for sale and deposits held for sale are carried at the lower of the carrying amount or fair value less costs to sell. The Company does not record depreciation expense on long-lived assets held for sale.

Securities Sold Under Agreements to Repurchase
From time to time, the Bank enters into sales of securities under agreements to repurchase, generally for periods of less than 90 days. These agreements are treated as financings, and the obligations to repurchase securities sold are reflected as a liability in the consolidated balance sheets as short-term borrowings. The costs of securities underlying the agreements remain in the asset accounts.

Fair Values of Financial Instruments
The Company is required to disclose the estimated fair value of financial instruments. Fair value estimates are subjective in nature, involving uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. The following methods and assumptions are used by the Company in estimating fair value disclosures for its financial instruments.

Cash and Cash Equivalents, Non-interest-Bearing Deposits and Demand Deposits. The carrying amounts approximate fair value due to the short maturity of the instruments. The fair value of deposits with no stated maturity, such as interest checking, savings and money market accounts, is equal to the amount payable on demand at the reporting date. The intangible value of long-term customer relationships with depositors is not taken into account in the fair values disclosed.

Investment Securities Available for Sale. The fair value of the Company's securities are 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 significant assumptions are observable in the market.

Federal Reserve Bank and Federal Home Loan Bank Stock. The carrying amount of FRB and FHLB stock is their cost, which approximates fair value.

Loans Held for Sale-Mortgage Banking. Loans held for sale-mortgage banking are accounted for at fair value pursuant to the fair value option permitted by FASB ASC 825, *Financial Instruments*.

Participating Interests in Mortgage Loans, Loans and Leases Held for Investment. Fair values of these assets are estimated by discounting future cash flow payment streams using rates at which current loans to borrowers with similar credit ratings and similar loan maturities are being made. The estimated fair values are not exit prices.

Other Loans Held for Sale. The fair value of other loans held for sale is determined by the agreed upon contractual selling price.

Accrued Interest Receivable. The fair value of accrued interest receivable equals the amount receivable due to the current nature of the amounts receivable.

Derivative Financial Instruments. The fair value of the Company's derivatives are 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 significant assumptions are observable in the market.

Interest-Bearing Deposits. Fair values of interest-bearing deposit liabilities are estimated by discounting future cash flow payment streams using rates at which comparable current deposits with comparable maturities are being issued.
Deposits Held for Sale. The fair value of deposits held for sale is determined by the agreed upon contractual price.

Borrowings and Advances. The carrying amount of short-term borrowings approximates fair value due to the short maturity and the instruments' floating interest rates, which are tied to market conditions. The fair values of long-term borrowings are estimated by discounting future cash flow payment streams using rates at which comparable borrowings are currently being offered.

Accrued Interest Payable. The fair value of accrued interest payable equals the amount payable due to the current nature of the amounts payable.

Guaranteed Preferred Beneficial Interests In Company's Subordinated Debentures. The fair values of the Company's subordinated debentures are estimated by discounting future cash flow payment streams using discount rates estimated to reflect those at which comparable instruments could currently be offered.

Financial Instruments with Off-Balance-Sheet Risk. The fair values of the Company's commitments to extend credit and commercial and standby letters of credit are estimated using fees currently charged to enter into similar agreements.

Derivative Financial Instruments
FASB ASC 815, *Derivatives and Hedging*, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Accordingly, the Company records all derivatives at fair value.

The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

Derivative instruments that qualify for specific hedge accounting are recorded at fair value and classified either as a hedge of the fair value of a recognized asset or liability (fair value hedge) or as a hedge of the variability of cash flows to be received or paid related to a recognized asset or liability or a forecasted transaction (cash flow hedge). All relationships between hedging instruments and hedged items are formally documented, including the risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as hedges to specific assets or liabilities on the balance sheet.

Changes in the fair value of a derivative that is highly effective and designated as a fair value hedge and the offsetting changes in the fair value of the hedged item are recorded in income. Changes in the fair value of a derivative that is highly effective and designated as a cash flow hedge are recognized in other comprehensive income until income from the cash flows of the hedged item are recognized. The Company performs an assessment, both at the inception of the hedge and on a quarterly basis thereafter, to determine whether these derivatives are highly effective in offsetting changes in the value of the hedged items. Any change in fair value resulting from hedge ineffectiveness is immediately recorded in income.

The Company enters into interest rate lock commitments on certain mortgage loans, which are commitments to originate loans whereby the interest rate on the loan is determined prior to funding. The Company also has corresponding forward sales contracts related to these interest rate lock commitments. Both the mortgage loan commitments and the related forward sales contracts are accounted for as derivatives and carried at fair value with changes in fair value recorded in income.

Earnings (Loss) Per Share
Basic earnings (loss) per share (EPS) excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the applicable period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock

were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Such potential dilutive instruments include stock options and contingently issuable stock. Note 25 to these consolidated financial statements includes disclosure of the Company's EPS calculations.

Comprehensive Income (Loss)
Comprehensive income (loss) is the total of net income (loss) and other comprehensive income (loss), which for the Company, is generally comprised of unrealized gains and losses on securities available for sale and unrealized gains and losses on hedging instruments qualifying for cash flow hedge accounting treatment pursuant to FASB ASC 815.

The Company separately presents consolidated statements of comprehensive income (loss).

Cash and Cash Equivalents
For purposes of the Consolidated Statements of Cash Flows, cash and cash equivalents include cash on hand, cash due from banks and federal funds sold.

Share-Based Compensation
FASB ASC 718 requires the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date.

At December 31, 2010, the Company had four stock-based employee compensation plans, which are described more fully in Note 28 to these consolidated financial statements.

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS

FASB ASC 810, *Consolidation*, requires a qualitative rather than a quantitative analysis to determine the primary beneficiary of a variable interest entity (VIE) for consolidation purposes. The primary beneficiary of a VIE is the enterprise that has the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and also has the obligation to absorb the losses of the VIE that could potentially be significant to the VIE or the right to receive benefits of the VIE that could potentially be significant to the VIE. The provisions of ASC 810 were effective January 1, 2009. The adoption of ASC 810 did not have a material impact on our consolidated financial statements.

FASB ASC 860, *Transfers and Servicing,* removes the concept of a qualifying special-purpose entity. It clarifies that a transferor must evaluate whether it has maintained effective control of a financial asset by considering its continuing direct or indirect involvement with the transferred financial asset. The provisions of ASC 860 were effective for financial asset transfers occurring after December 31, 2009. The adoption of ASC 860 did not have a material impact on our consolidated financial statements.

FASB ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820), Improving Disclosures and Fair Value Measurements,* requires new investment fair market disclosures in order to increase the transparency in the financial reporting of investments. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010. The adoption of this ASU in 2010 did not have a material impact on the Company's consolidated financial statements.

FASB ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, requires significant new disclosures about the allowance for credit losses and the credit quality of financing receivables. The requirements are intended to enhance transparency regarding credit losses and the credit quality of loan and lease receivables. Under this statement, allowance for credit losses and fair value are to be disclosed by portfolio segment, while credit quality information, impaired financing receivables and nonaccrual status are to be presented by class of financing receivable. Disclosure of the nature and extent, the financial impact and segment information of troubled debt restructurings will also be required. The disclosures are to be presented at the level of disaggregation that management uses when assessing and monitoring the portfolio's

risk and performance. This ASU is effective for reporting periods after December 15, 2011 for non-public companies.

FASB ASU No. 2010-18, *Receivables (Topic 310): Effect of a Loan Modification When the Loan Is Part of a Pool That is Accounted for as a Single Asset*, clarifies the accounting for acquired loans that have evidence of a deterioration in credit quality since origination (referred to as "Subtopic 310-30 Loans"). Under this ASU, an entity may not apply troubled debt restructuring ("TDR") accounting guidance to individual Subtopic 310-30 loans that are part of a pool, even if the modification of those loans would otherwise be considered a troubled debt restructuring. Once a pool is established, individual loans should not be removed from the pool unless the entity sells, forecloses, or writes off the loan. Entities would continue to consider whether the pool of loans is impaired if expected cash flows for the pool change. Subtopic 310-30 loans that are accounted for individually would continue to be subject to TDR accounting guidance. A one-time election to terminate accounting for loans as a pool, which may be made on a pool-by-pool basis, is provided upon adoption of the ASU. This ASU is effective for annual periods ending on or after July 15, 2010 and should be applied prospectively. Adoption of this ASU did not have a material effect on the Company's consolidated financial statements.

RECLASSIFICATIONS

Certain amounts in the consolidated financial statements for the prior year have been reclassified to conform to the current year's presentation. These reclassifications had no effect on net income or stockholders' equity.

NOTE 2. Regulatory Capital and Current Operating Environment

BNCCORP and the Bank are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet capital requirements mandated by regulators can initiate certain mandatory and additional discretionary actions by regulators. Such actions, if undertaken, could have a direct material adverse effect on the Company's financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, BNCCORP and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. With increasing frequency, regulators are imposing capital requirements that are specific to individual institutions. The requirements are generally above the statutory ratios.

Actual capital amounts and ratios of BNCCORP and the Bank as of December 31 are presented in the tables below (dollars in thousands):

	Actual		To be Well Capitalized	
	Amount	Ratio	Amount	Ratio
2010				
Total Capital (to risk-weighted assets):				
Consolidated	$ 65,601	13.23 %	$ N/A	N/A
BNC National Bank	63,380	12.80	49,515	10.0 %
Tier 1 Capital (to risk-weighted assets):				
Consolidated	46,885	9.46	N/A	N/A
BNC National Bank	57,106	11.53	29,709	6.0
Tier 1 Capital (to average assets):				
Consolidated	46,885	6.17	N/A	N/A
BNC National Bank	57,106	7.53	37,932	5.0
Tangible Capital (to total assets):				
Consolidated tangible equity	37,226	4.98	N/A	N/A
BNC National Bank	59,622	8.00	N/A	N/A
Tangible Common Capital (to total assets):				
Consolidated tangible common equity	16,740	2.24	N/A	N/A
2009				
Total Capital (to risk-weighted assets):				
Consolidated	$ 89,102	14.15 %	N/A	N/A
BNC National Bank	85,195	13.52	63,017	10.0 %
Tier 1 Capital (to risk-weighted assets):				
Consolidated	77,617	12.32	N/A	N/A
BNC National Bank	77,192	12.25	37,810	6.0
Tier 1 Capital (to average assets):				
Consolidated	77,617	8.58	N/A	N/A
BNC National Bank	77,192	8.54	45,187	5.0
Tangible Capital (to total assets):				
Consolidated tangible equity	57,018	6.57	N/A	N/A
BNC National Bank	74,989	8.65	N/A	N/A
Tangible Common Capital (to total assets):				
Consolidated tangible common equity	36,733	4.23	N/A	N/A

In the current operating environment, management believes banking entities are regularly required to maintain capital ratios in excess of the statutory amounts required to remain well capitalized. We are managing capital accordingly. After the pending divestiture discussed in Note 3 the regulatory capital ratios of the Bank will improve.

As of December 31, 2010, the most recent notifications from the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. Management believes the Bank remains well capitalized through the date for which subsequent events have been evaluated.

In February of 2010, the Bank entered into an agreement with the OCC with three articles primarily pertaining to credit administration. The agreement requires the Bank's board of directors to address three articles that can be summarized as follows:

(1) Develop, and implement a written program to identify and monitor credit and underwriting exceptions from loan policy;

(2) Adopt, implement and ensure adherence to a written asset diversification program that limits concentrations of assets to prescribed limits; and

(3) Adopt, implement and ensure adherence to work out plans designed to reduce criticized assets. The work out plans are to be updated quarterly.

Management believes policies and procedures implemented in 2010 adequately addressed the articles summarized above. However, more time is needed before the OCC will remove the articles.

In April 2010, BNCCORP entered into a memorandum of understanding that restricts dividend payments and/or payment of interest on the holding company's common stock, preferred stock, and debt. Payments of this nature are not permitted without prior written approval from the Federal Reserve Bank. The memorandum of understanding also restricts the holding company from increasing debt without prior written consent from the Federal Reserve.

NOTE 3. Pending Divestiture

On November 19, 2010, the Bank entered into a definitive agreement to sell certain loans, premises and equipment and deposits in the Company's Minnesota and Arizona markets. The transaction was approved by regulators in January 2011 and was completed in March of 2011. The Bank is not prohibited from continuing to service these markets as a result of this transaction, although the Bank has agreed not to solicit certain customers for a limited period of time following the closing. After the sale, the Company will continue to offer a full complement of banking, mortgage banking and wealth management services in North Dakota, Minnesota and Arizona.

As of December 31, 2010, the assets and liabilities included in the divestiture have been classified as held for sale. As of December 31, 2010, the carrying value of the loans held for sale related to the divestiture was $70.5 million. The total loans held for sale as of December 31, 2010 is $72.2 million and the allowance for losses allocated to these loans at year end is $1.7 million. The carrying value of premises and equipment held for sale related to the divestiture was $2.8 million. The carrying value of deposits held for sale related to the divestiture was $107.5 million. There is no gain or loss expected to be incurred as a result of the divestiture.

NOTE 4. Fraud Loss on Assets Serviced by Others

In April of 2010, the Company discovered fraudulent activity perpetrated by an external company that was engaged to service residential mortgage loans for BNC. Since the discovery of this activity, the Company and its advisors have been diligently working to determine the scope of the loss and identify any remedies that may be available. In the second quarter, the Company determined the scope of the losses and recorded a loss of $26.231 million. Our internal and external investigations have confirmed that this fraudulent activity was limited to this external servicing company and that no bank employees were involved in or were aware of this wrongful conduct by the servicing company. As such, we believe these losses are not indicative of other credit quality problems within our loan portfolio.

In mid-year 2010, we submitted claims under our fidelity insurance policies seeking to recover the insured portion of these losses. The policies together provide for total coverage of $15 million. However, as of mid-October, our insurance carriers commenced a declaratory judgment action against the Company in an Arizona federal court seeking a judicial determination that the losses associated with the servicing fraud are not covered by the policies. We have subsequently filed a counter claim against the insurance carriers for failure to honor the policies and for acting in bad faith. This litigation commenced in early 2011; and we anticipate discovery procedures will take all of 2011 to complete.

We intend to vigorously pursue our claims to recover amounts due under the insurance policies and for losses incurred as a result of our belief that the carriers acted in bad faith. While management believes we have strong claims, there can be no assurances as to the outcome of this litigation, or if we will recover all or any portion of the insured amounts.

NOTE 5. Restrictions on Cash and Cash Equivalents

The Bank is required to maintain reserve balances in cash on hand or with the FRB. The required reserve balances were $25,000 as of December 31, 2010 and 2009.

NOTE 6. Investment Securities Available For Sale

Investment securities have been classified in the consolidated balance sheets according to management's intent. The Company had no securities designated as trading or held-to-maturity in its portfolio at December 31, 2010 or 2009. The carrying amount of available-for-sale securities and their approximate fair values were as follows as of December 31 (in thousands):

	2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	$ 965	$ 35	$ -	$ 1,000
U.S. government agency mortgage-backed securities issued by FNMA	1,863	116	(1)	1,978
Collateralized mortgage obligations guaranteed by GNMA	89,056	908	(275)	89,689
Collateralized mortgage obligations issued by FNMA or FHLMC	930	67	-	997
Other collateralized mortgage obligations	39,518	1,889	(152)	41,255
State and municipal bonds	1,911	202	-	2,113
	$ 134,243	$ 3,217	$ (428)	$ 137,032

	2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	$ 1,223	$ 39	$ -	$ 1,262
U.S. government agency mortgage-backed securities issued by FNMA	2,500	102	(3)	2,599
Collateralized mortgage obligations guaranteed by GNMA	86,600	531	(114)	87,017
Collateralized mortgage obligations issued by FNMA or FHLMC	1,797	90	-	1,887
Other collateralized mortgage obligations	118,375	3,349	(4,513)	117,211
State and municipal bonds	2,521	164	-	2,685
	$ 213,016	$ 4,275	$ (4,630)	$ 212,661

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at December 31, 2010, were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ -	$ -
Due after one year through five years	-	-
Due after five years through ten years	11,090	11,490
Due after ten years	123,153	125,542
Total	$ 134,243	$ 137,032

For many types of investments, the actual payment will vary significantly from contractual maturities.

Securities carried at approximately $74.0 million and $129.0 million at December 31, 2010 and 2009, respectively, were pledged as collateral for public and trust deposits and borrowings, including borrowings from the FHLB and repurchase agreements with customers.

Sales proceeds and gross realized gains and losses on available-for-sale securities were as follows for the years ended December 31 (in thousands):

	2010	2009
Sales proceeds	$ 84,450	$ 71,553
Gross realized gains	4,791	2,850
Gross realized losses	(401)	-

The following table shows the Company's investments' gross unrealized losses and fair value aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31 (in thousands):

	2010								
	Less than 12 months			12 months or more			Total		
Description of Securities	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. government agency mortgage-backed securities guaranteed by GNMA	-	$ -	$ -	-	$ -	$ -	-	$ -	$ -
U.S. government agency mortgage-backed securities issued by FNMA	-	-	-	1	57	(1)	1	57	(1)
Collateralized mortgage obligations guaranteed by GNMA	5	19,822	(275)	-	-	-	5	19,822	(275)
Collateralized mortgage obligations issued by FNMA or FHLMC	-	-	-	-	-	-	-	-	-
Other collateralized mortgage obligations	2	339	(3)	2	7,276	(149)	4	7,615	(152)
State and municipal bonds	-	-	-	-	-	-	-	-	-
Total temporarily impaired securities	7	$ 20,161	$ (278)	3	$ 7,333	$ (150)	10	$ 27,494	$ (428)

	2009								
	Less than 12 months			12 months or more			Total		
Description of Securities	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. government agency mortgage-backed securities guaranteed by GNMA	-	$ -	$ -	-	$ -	$ -	-	$ -	$ -
U.S. government agency mortgage-backed securities issued by FNMA	-	-	-	1	57	(3)	1	57	(3)
Collateralized mortgage obligations guaranteed by GNMA	6	34,394	(114)	-	-	-	6	34,394	(114)
Collateralized mortgage obligations issued by FNMA or FHLMC	-	-	-	-	-	-	-	-	-
Other collateralized mortgage obligations	8	29,622	(1,715)	8	22,591	(2,798)	16	52,213	(4,513)
State and municipal bonds	-	-	-	-	-	-	-	-	-
Total temporarily impaired securities	14	$ 64,016	$ (1,829)	9	$ 22,648	$ (2,801)	23	$ 86,664	$ (4,630)

Management regularly evaluates each security with unrealized losses to determine whether losses are other–than-temporary. When the evaluation is performed, management considers several factors including, but not limited to, the amount of the unrealized loss, the length of time the security has been in a loss position, guarantees provided by third parties, ratings on the security, cash flow from the security and collateral backing the security.

We have been receiving principal payments on all securities since acquisition and the current credit support on all securities is higher than the credit support provided at the inception of the bond.

For the non-agency securities with unrealized losses at December 31, 2010, the collateral is generally based on loans originated between 2001 and 2004, and as a result the loan to value ratios of the underlying loans generally indicates risk of loss is relatively low.

All securities owned are investment grade, except one. For this security, and a few other securities that have been in an unrealized loss position for a longer period, we obtained credit surveillance reports that provide prospective analysis of the securities performance under various scenarios. The credit surveillance reports do not currently project credit losses.

There were no securities that management concluded were other-than-temporarily impaired in either 2010 or 2009.

NOTE 7. Federal Reserve Bank and Federal Home Loan Bank of Des Moines Stock

The carrying amounts of FRB and FHLB stock, which approximate their fair values, consisted of the following as of December 31 (in thousands):

	2010	2009
Federal Reserve Bank Stock, at cost	$ 1,772	$ 1,297
Federal Home Loan Bank of Des Moines Stock, at cost	1,090	1,751
Total	$ 2,862	$ 3,048

There is no contractual maturity on these investments; the investments are required by counterparties.

NOTE 8. Loans and Leases

Loan Portfolio Composition

The composition of loans and leases is as follows at December 31 (in thousands):

	2010			2009
	Loans and Leases, excluding Loans Held for Sale-Mortgage Banking	Other Loans Held for Sale	Total Loans and Leases Held for Investment	Total Loans and Leases Held for Investment
Commercial and industrial	$ 93,859	$ 17,242	$ 76,617	$ 124,773
Real estate:				
Mortgage	262,597	50,745	211,852	266,051
Construction	44,289	3,303	40,986	96,327
Participating interests in mortgage loans	4,888	-	4,888	38,534
Agricultural	15,114	-	15,114	23,142
Other	7,211	982	6,229	7,397
Total gross loans held for investment	427,958	72,272	355,686	556,224
Unearned income and net unamortized deferred fees and costs	(357)	(60)	(297)	(582)
Loans, net of unearned income and unamortized fees and costs	427,601	72,212	355,389	555,642
Allowance for credit losses	(16,476)	(1,711)	(14,765)	(18,047)
Net loans and leases	$ 411,125	$ 70,501	$ 340,624	$ 537,595

Commercial and industrial loan borrowers are generally small and mid-sized corporations, partnerships and sole proprietors in a wide variety of businesses. Real estate loans are fixed or variable rate and include both amortizing and revolving line-of-credit loans. Real estate mortgage loans include various types of loans for which the Bank holds real property as collateral. Agricultural loans include loans to grain and/or livestock producers, agricultural real estate loans, machinery and equipment and other types of loans. Loans to consumers are both secured and unsecured.

Impaired Loans

As of December 31, the Bank's recorded investment in impaired loans and the related valuation allowance was as follows (in thousands):

	2010		2009	
	Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance
Impaired loans -				
Valuation allowance required	$ 17,819	$ 2,710	$ 33,821	$ 3,998
No valuation allowance required	43	-	2,377	-
Total impaired loans	$ 17,862	$ 2,710	$ 36,198	$ 3,998

Impaired loans include loans the Bank will not be able to collect all amounts due in accordance with the terms of the loan agreement.

The valuation allowance on impaired loans is included in the Bank's allowance for credit losses. The following tables present information on impaired loans for the years ended December 31 (in thousands):

	2010	2009
Average recorded investment in impaired loans	$ 19,964	$ 37,766
Average recorded investment in impaired loans as a percentage of average total loans	3.73%	6.29%

	Year Ended December 31, 2010	Year Ended December 31, 2009
Interest income recognized on impaired loans	$ 208	$ 1
Interest income recognized on a cash basis during the time of impairment	-	1

Nonperforming Loans

As of December 31, the Bank's nonperforming loans were as follows (in thousands):

	2010	2009
Loans 90 days or more delinquent and still accruing interest	$ -	$ 1
Non-accrual loans	17,862	35,889
Total nonperforming loans	$ 17,862	$ 35,890

The table below summarizes the amounts of restructured loans as of the dates indicated (in thousands):

	December 31,	
	2010	2009
Restructured loans	$ 34,264	$ 14,337

Loans to Related Parties

Note 23 to these consolidated financial statements includes information relating to loans to executive officers, directors, principal shareholders and associates of such persons.

Leases
The Bank extends credit to borrowers under direct finance lease obligations. The direct finance lease obligations are stated at their outstanding principal amount net of unearned income and net of unamortized deferred fees and costs. At December 31, 2010, the future minimum annual lease payments for direct finance lease obligations were as follows (in thousands):

2011	$ 225
2012	24
2013	-
2014	-
2015	-
Thereafter	-
Total future minimum lease payments	249
Unguaranteed residual values	243
Total all payments	492
Unearned income	(22)
Net outstanding principal amount	$ 470

Loans Pledged as Collateral

The table below presents loans pledged as collateral to the Federal Home Loan Bank, Federal Reserve Bank, and the Bank of North Dakota as of December 31(in thousands):

	2010	2009
Commercial and industrial	$ 9,706	$ 5,770
Real estate mortgage	130,016	139,317
Real estate construction	-	3,897
Agricultural	2,370	-
Loans held for sale	-	22,826
	$ 142,092	$ 171,810

NOTE 9. Allowance for Credit Losses

Transactions in the allowance for credit losses were as follows for the years ended December 31 (in thousands):

	2010	2009
Balance, beginning of year	$ 18,047	$ 8,751
Provision for credit losses	5,750	27,000
Loans charged off	(7,786)	(17,876)
Loan recoveries	465	172
	16,476	18,047
Transferred to other loans held for sale	(1,711)	-
Balance end of year	$ 14,765	$ 18,047

NOTE 10. Other Real Estate

Other real estate (ORE) includes property acquired through foreclosure, property in judgment and in-substance foreclosures. ORE is carried at fair value less estimated selling costs. Each property is evaluated regularly and the amounts provided to decrease the carrying amount are included in non-interest expense. A summary of the activity related to ORE is presented below for the years ended December 31 (in thousands):

	2010	2009
Balance, beginning of year	$ 7,253	$ 10,189
Transfers from nonperforming loans	11,332	8,132
Real estate sold	(3,370)	(3,012)
Net gains (losses) on sale of assets	(126)	1
Provision	(2,383)	(8,057)
Balance, end of year	$ 12,706	$ 7,253

NOTE 11. Premises and Equipment, net

Premises and equipment, net consisted of the following at December 31 (in thousands):

	2010	2009
Land and improvements	$ 5,220	$ 6,692
Buildings and improvements	11,393	12,957
Leasehold improvements	1,611	1,807
Furniture, fixtures and equipment	9,133	9,440
Total cost	27,357	30,896
Less accumulated depreciation and amortization	(10,673)	(10,474)
Net premises, leasehold improvements and equipment	$ 16,684	$ 20,422

Depreciation and amortization expense totaled approximately $1.3 million and $1.5 million for the years ended December 31, 2010 and 2009, respectively.

NOTE 12. Deposits

The scheduled maturities of time deposits as of December 31, 2010 are as follows (in thousands):

	Time Deposits	Deposits-Held for Sale	Time Deposits, net
2011	$ 145,946	$ 21,454	$ 124,492
2012	24,019	3,196	20,823
2013	5,314	373	4,941
2014	10,946	52	10,894
2015	7,403	-	7,403
Thereafter	50,302	-	50,302
	$ 243,930	$ 25,075	$ 218,855

At December 31, 2010 and 2009, the Bank had $67.0 million and $115.8 million, respectively, of time deposits that had been acquired through a broker.

The following table shows a summary of interest expense by product type as of December 31 (in thousands):

	2010	2009
Savings	$ 11	$ 13
Interest checking	659	349
Money market	1,070	2,028
Time deposits	7,068	9,996
	$ 8,808	$ 12,386

Deposits Received from Related Parties
Note 23 to these consolidated financial statements includes information relating to deposits received from executive officers, directors, principal shareholders and associates of such persons.

NOTE 13. Short-Term Borrowings

The following table sets forth selected information for short-term borrowings (borrowings with an original maturity of less than one year) as of December 31 (in thousands):

	2010	2009
Federal reserve borrowings-U. S. Treasury tax and loan retainer	$ 2,000	$ 1,315
Repurchase agreements with customers, renewable daily, interest payable monthly, rates ranging from 0.25% to 0.90% in 2010, and 0.50% to 1.15% in 2009, secured by government agency collateralized mortgage obligations	14,329	8,875
	$ 16,329	$ 10,190

The weighted average interest rate on short-term borrowings outstanding as of December 31, 2010 and 2009 was 0.48% and 0.70%, respectively.

Customer repurchase agreements are used by the Bank to acquire funds from customers where the customers are required, or desire, to have their funds supported by collateral consisting of government, government agency or other types of securities. The repurchase agreement is a promise to sell these securities to a customer at a certain price and repurchase them at a future date at that same price plus interest accrued at an agreed upon rate. The Bank uses customer repurchase agreements in its liquidity plan as well as an accommodation to customers. At December 31, 2010, $14.3 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.56%, maturing in 2010, were collateralized by government agency collateralized mortgage obligations having a market value of $23.7 million and unamortized principal balances of $22.5 million. At December 31, 2009, $8.9 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.80%, maturing in 2010, were collateralized by government agency collateralized mortgage obligations having a market value of $19.5 million and unamortized principal balances of $19.4 million.

NOTE 14. Federal Home Loan Bank Advances

FHLB advances consisted of the following at December 31 (in thousands):

	2010		2009	
Year of Maturity	Amount	Weighted Average Rate	Amount	Weighted Average Rate
2010	$ -	- %	$ -	- %
2013	-	-	15,000	3.99
2015	-	-	-	-
	$ -	- %	15,000	3.99 %

As of December 31, 2010, the Bank had $0 of FHLB advances outstanding. On March 10, 2010 the Bank exercised its option to repay the $15.0 million advance maturing in 2013 that was outstanding as of December 31, 2009. The Bank exercised this option without a prepayment penalty.

At December 31, 2010, the Bank has mortgage loans with unamortized principal balances of approximately $125.1 million and securities with unamortized principal balances of approximately $21.9 million which were pledged as collateral to the FHLB. The Bank has the ability to draw advances up to approximately $76 million based upon the mortgage loans and securities that are currently pledged, subject to a requirement to purchase additional FHLB stock.

At December 31, 2010 the Bank's ability to borrow funds from the FHLB is limited to borrowings of a short maturity, (i.e. 30 days or less).

NOTE 15. Other Borrowings

As of December 31, 2010, BNC National Bank had a secured federal funds line with the Bank of North Dakota. No funds were advanced on the line as of December 31, 2010 and 2009. Interest on the line if advanced upon would be at the federal funds rate. The line is secured by marketable securities with a carrying value of $6.2 million as of December 31, 2010 resulting in unused borrowing capacity of $5.0 million.

NOTE 16. Guaranteed Preferred Beneficial Interest's in Company's Subordinated Debentures

In July 2007, BNCCORP issued $15.0 million of floating rate subordinated debentures. The interest rate paid on the securities is equal to the three month LIBOR plus 1.40%. The interest rate at December 31, 2010 was 1.69% and the interest rate reset on January 3, 2011 to 1.70%. The subordinated debentures mature on October 1, 2037. On or after October 1, 2012, the subordinated debentures may be redeemed at par and the corresponding debentures may be prepaid at the option of BNCCORP, subject to approval by the Federal Reserve.

In July 2000, BNCCORP issued $7.5 million of subordinated debentures at 12.05%. The subordinated debentures are subject to mandatory redemption on July 19, 2030. On or after July 19, 2010, the subordinated debentures may be redeemed and the corresponding debentures may be prepaid at the option of BNCCORP at declining redemption prices. Redemption is subject to approval by the Federal Reserve.

Commencing in January 2010, BNCCORP deferred interest payments on its subordinated debentures as it is permitted pursuant to contractual terms of the agreements. While the subordinated debenture agreements permit interest to be deferred for up to 60 months, interest on the subordinated debentures continues to accrue during deferment and has been recorded in the consolidated financial statements at December 31, 2010.

The agreements that contractually permit the deferral of interest on the subordinated debentures require that dividends on junior securities be suspended while interest payments on the subordinated debentures are deferred.

NOTE 17. Stockholders' Equity

On January 16, 2009, BNCCORP received net proceeds of approximately $20.1 million through the sale of shares of non-voting senior preferred stock to the U.S. Department of the Treasury under the Capital Purchase Program (CPP). The Treasury Department also received a warrant exercisable for shares of an additional class of BNCCORP, INC. preferred stock which has an aggregate liquidation preference of approximately $1.0 million. The Treasury Department exercised this warrant on January 16, 2009.

As a result of participating in the CPP, there are two series of preferred stock outstanding. One series is perpetual, non-voting and pays dividends at 5% of its liquidation preference per annum until the fifth anniversary of the Treasury Department's investment and thereafter pays a dividend of 9%. There are 20,093 shares of this series outstanding as of December 31, 2010 and 2009. Each share has a liquidation preference of $1,000 per share. This series of shares can not be redeemed without prior approval from regulatory authorities.

The second series of preferred stock has the same voting rights and privileges as the other series, except that this series pays dividends at 9% of its liquidation preference per annum and may not be redeemed until the other series has been redeemed. There are 1,005 shares of this series outstanding at December 31, 2010 and 2009.

The relative fair value method was used to allocate the values of the two series of preferred stock. Management assumed both series of preferred stock would be redeemed in five years. A 6.51% discount rate was used to determine the values of the preferred stock.

As a result of deferring interest on subordinated debentures, BNCCORP was contractually required to cease payment of dividends on the CPP preferred stock beginning with the quarterly payment due February 2010. The Treasury department is permitted to appoint a representative to the Board of Directors (the Board) of BNCCORP if dividend payments on the CPP preferred stock have not been made for six consecutive quarters. The Company has recorded the accrued dividends in the consolidated financial statement as of December 31, 2010.

BNCCORP and the Bank are subject to certain minimum capital requirements (see Note 2 to these consolidated financial statements). BNCCORP is subject to certain restrictions on the amount of dividends it may declare without prior regulatory approval pursuant to the Federal Reserve Act. The terms of the preferred stock issued under the CPP precludes certain dividend payments to common shareholders and certain repurchases of outstanding shares of common stock until the preferred shares have been redeemed.

Regulatory restrictions exist regarding the ability of the Bank to transfer funds to BNCCORP in the form of cash dividends. Approval of the Office of the Comptroller of the Currency (OCC), the Bank's principal regulator, is required for the Bank to pay dividends to BNCCORP in excess of the Bank's net profits from the current year plus retained net profits for the preceding two years. At December 31, 2010, the Bank would require prior regulatory approval to pay any dividends to BNCCORP.

On May 30, 2001, BNCCORP's Board adopted a rights plan intended to protect stockholder interests in the event BNCCORP becomes the subject of a takeover initiative that BNCCORP's Board believes could deny BNCCORP's stockholders the full value of their investment. This plan does not prohibit the Board from considering any offer that it deems advantageous to its stockholders. BNCCORP has no knowledge that anyone is considering a takeover.

The rights were issued to each common stockholder of record on May 30, 2001, and they will be exercisable only if a person acquires, or announces a tender offer that would result in ownership of, 15% or more of BNCCORP's outstanding common stock. The rights will expire on May 30, 2011, unless redeemed or exchanged at an earlier date.

NOTE 18. Derivative Instruments and Hedging Activities

Risk Management Objective of Using Derivatives

The Company is exposed to certain risks arising from both its business operations and economic conditions. The Company manages economic risks, including interest rate and liquidity risk, primarily by managing the amount, sources, and duration of its assets and liabilities and secondarily through the use of derivative financial instruments. In prior periods, the Company entered into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments were used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to certain variable-rate loan assets.

Fair Values of Derivative Instruments on the Consolidated Balance Sheets

The Company had an interest rate floor that matured in January 2010.The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the Consolidated Balance Sheets as of December 31, 2010 and 2009 (in thousands):

Tabular Disclosure of Fair Values of Derivative Instruments

	Asset Derivatives				Liability Derivatives			
	2010		2009		2010		2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives Designated as Hedging Instruments								
Interest Rate Floor	Other Assets	$ -	Other Assets	$ -	Other Liabilities	$ -	Other Liabilities	$ -
Total Derivatives Designated as Hedging Instruments		$ -		$ -		$ -		$ -
Derivatives **Not** Designated as Hedging Instruments								
Interest Rate Floor	Other Assets	$ -	Other Assets	$ 49	Other Liabilities	$ -	Other Liabilities	$ -
Total Derivatives **Not** Designated as Hedging Instruments		$ -		$ 49		$ -		$ -

Cash Flow Hedges of Interest Rate Risk

The Company's objective in using interest rate derivatives is to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily used interest rate floors as part of its interest rate risk management strategies. Interest rate floors involve the receipt of variable-rate amounts from a counterparty if interest rates fall below the strike rate on the contract in exchange for an up front premium.

Effect of Derivative Instruments on the Statements of Operations

The tables below present the effect of the Company's derivative financial instruments on the Statements of Operations for the years ended December 31 (in thousands):

Derivatives in Cash Flow Hedging Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2010	2009	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2010	2009	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) 2010	2009
Interest Rate Floor	$ -	$ 43	Interest Income	$ 40	$ 1,545	Other Income	$ -	$ (12)
			Other Income	-	10			
Total	$ -	$ 43		$ 40	$ 1,555		$ -	$ (12)

Non-designated Hedges

The Company does not use derivatives for trading or speculative purposes. Derivatives not designated as hedges are used to manage the Company's exposure to interest rate movements and other identified risks but do not meet the strict hedge accounting requirements. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in earnings. The Company's $50 million interest rate floor disqualified for hedge accounting as of April 1, 2009; accordingly, the changes in fair value of the floor subsequent to March 31, 2009 were recognized directly in earnings.

The amount recorded in operations shown in the table below represents the net effect of changes in fair value of the interest rate floor and cash receipts for the years ended December 31 (in thousands):

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative	
		2010	2009
Interest Rate Floor	Other Income	$ (7)	$ 23
Total		$ (7)	$ 23

NOTE 19. Fair Value Measurements

The following table summarizes the financial assets and liabilities of the Company for which fair values are determined on a recurring basis as of December 31 (in thousands):

	2010			
	Total	Level 1	Level 2	Level 3
ASSETS				
Securities available for sale	$ 137,032	$ -	$ 137,032	$ -
Loans held for sale-mortgage banking	29,116	-	29,116	-
Commitments to originate mortgage loans	488	-	488	-
Total assets at fair value	$ 166,636	$ -	$ 166,636	$ -
LIABILITIES				
Commitments to sell mortgage loans	$ 470	$ -	$ 470	$ -
Total liabilities at fair value	$ 470	$ -	$ 470	$ -

	2009			
	Total	Level 1	Level 2	Level 3
ASSETS				
Securities available for sale	$ 212,661	$ -	$ 212,661	$ -
Loans held for sale-mortgage banking	24,130	-	24,130	-
Commitments to originate mortgage loans	427	-	427	-
Interest rate floor	49	-	49	-
Total assets at fair value	$ 237,267	$ -	$ 237,267	$ -
LIABILITIES				
Commitments to sell mortgage loans	$ 675	$ -	$ 675	$ -
Total liabilities at fair value	$ 675	$ -	$ 675	$ -

Changes in the fair value of assets and liabilities determined on a recurring basis in the tables above had no net impact on our Consolidated Statements of Operations for the years ended December 31, 2010 and 2009. See Note 1 to these consolidated financial statements for definitions of Level 1, Level 2 and Level 3 inputs.

The Company may also be required from time to time to measure certain other assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These adjustments to fair value usually result from the application of the lower of cost or market accounting or write-down of individual assets. For assets measured at fair value on a nonrecurring basis the following table provides the level of valuation assumptions used to determine the carrying value at December 31 (in thousands):

	2010				
	Total	**Level 1**	**Level 2**	**Level 3**	**Total gains/ (losses)**
Impaired loans[1]	$ 15,152	$ -	$ 15,152	$ -	$ (3,182)
Other real estate[2]	12,706	-	12,706	-	(2,509)
Total	$ 27,858	$ -	$ 27,858	$ -	$ (5,691)

	2009				
	Total	**Level 1**	**Level 2**	**Level 3**	**Total gains/ (losses)**
Impaired loans[1]	$ 32,200	$ -	$ 32,200	$	$ (7,268)
Other real estate[2]	7,253	-	7,253		(8,056)
Total	$ 39,453	$ -	$ 39,453	$	$ (15,324)

(1) Represents the carrying value and related write-downs of loans based on the appraised value of the collateral.
(2) Represents the fair value of the collateral less estimated selling costs and are based upon appraised values.

NOTE 20. Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments are as follows as of December 31 (in thousands):

	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Cash and cash equivalents	$ 112,847	$ 112,847	$ 35,362	$ 35,362
Investment securities available for sale	137,032	137,032	212,661	212,661
Federal Reserve Bank and Federal Home Loan Bank stock	2,862	2,862	3,048	3,048
Loans held for sale-mortgage banking	29,116	29,116	24,130	24,130
Participating interests in mortgage loans	4,888	4,888	38,534	38,534
Loans and leases held for investment, net	335,736	334,413	499,061	494,242
Other loans held for sale, net	70,501	70,501	-	-
Accrued interest receivable	2,138	2,138	2,970	2,970
Derivative financial instruments	-	-	216	216
	695,120	$ 693,797	815,982	$ 811,163
Other assets	49,180		52,101	
Other assets held for sale	2,769		-	
	$ 747,069		$ 868,083	
Liabilities and Stockholders' Equity:				
Deposits, noninterest-bearing	$ 91,478	$ 91,478	$ 98,658	$ 98,658
Deposits, interest-bearing	462,187	461,944	657,305	658,647
Deposits, noninterest-bearing held for sale	34,610	34,610	-	-
Deposits, interest-bearing held for sale	72,836	72,836	-	-
Borrowings and advances	16,329	16,329	25,190	25,278
Accrued interest payable	852	852	1,468	1,468
Accrued expenses	4,704	4,704	2,946	2,946
Guaranteed preferred beneficial interests in Company's subordinated debentures	24,134	11,356	22,890	11,266
	707,130	$ 694,109	808,457	$ 798,263
Other liabilities	2,618		2,361	
Stockholders' equity	37,321		57,265	
	$ 747,069		$ 868,083	
Financial instruments with off-balance-sheet risk:				
Commitments to extend credit		$ 31		$ 64
Standby and commercial letters of credit		37		41
Mortgage banking commitments to fund		488		427
Mortgage banking commitments to sell loans		470		675
		$ 1,026		$ 1,207

NOTE 21. Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Company is a party to various financial instruments with off-balance-sheet risk, primarily to meet the needs of its customers as well as to manage its interest rate risk. These instruments, which are issued by the Company for purposes other than trading, carry varying degrees of credit, interest rate or liquidity risk in excess of the amounts reflected in the consolidated balance sheets.

Commitments to Extend Credit
Commitments to extend credit are agreements to lend to a customer, which are binding, provided there is no violation of any condition in the contract, and generally have fixed expiration dates or other termination clauses. The contractual amount represents the Bank's exposure to credit loss in the event of default by the borrower. At December 31, 2010, based on current information, no losses were anticipated as a result of these commitments. The Bank manages this credit risk by using the same credit policies it applies to loans. Collateral is obtained to secure commitments based on management's credit assessment of the borrower. The collateral may include marketable securities, receivables, inventory, equipment or real estate. Since the Bank expects many of the commitments to expire without being drawn, total commitment amounts do not necessarily represent the Bank's future liquidity requirements related to such commitments.

In our mortgage banking operations we commit to extend credit for purposes of originating residential loans. We underwrite these commitments to determine whether each loan meets criteria established by the secondary market for residential loans. Forward commitments represent commitments to sell loans to third party investors and are entered into in the normal course of business.

The Company's participating interests in mortgage loans is related to three counterparties. As of December 31, 2010, there was a $26.6 million limit to our loan commitment with these relationships.

Standby and Commercial Letters of Credit
Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Commercial letters of credit are issued on behalf of customers to ensure payment or collection in connection with trade transactions. In the event of a customer's nonperformance, the Bank's credit loss exposure is up to the letter's contractual amount. At December 31, 2010, based on current information, no losses were anticipated as a result of these commitments. Management assesses the borrower's credit to determine the necessary collateral, which may include marketable securities, real estate, accounts receivable and inventory. Since the conditions requiring the Bank to fund letters of credit may not occur, the Bank expects our liquidity requirements related to such letters of credit to be less than the total outstanding commitments.

The contractual amounts of these financial instruments were as follows as of December 31 (in thousands):

	2010		2009	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to extend credit	$ 8,871	$ 45,058	$ 11,996	$ 60,819
Standby and commercial letters of credit	1,274	2,455	761	3,320

In addition to the amounts in the table above, our mortgage banking commitments to fund loans totaled $43.3 million for 2010 and $29.2 million for 2009. Also, our mortgage banking commitments to sell loans totaled $72.0 million for 2010 and $53.1 million for 2009.

Mortgage Banking Obligations
Through its mortgage banking operations, the Company originates and sells residential mortgage loans servicing released to third parties. These loans are sold without recourse to the Bank. However, standard industry practices require representations and warranties which generally require sellers to reimburse a portion of the sales proceeds if a sold loan defaults or pays off shortly after the sale of the loan (i.e. generally within four months of the sale.). The Company has recorded an obligation of $500 thousand and $326 thousand as of December 31, 2010 and 2009

for the estimated obligation reimbursement. Bank management believes the recorded obligation adequately addresses potential reimbursement obligations existing as of December 31, 2010 and 2009.

NOTE 22. Guarantees and Contingent Consideration

Guaranteed Preferred Beneficial Interests In Company's Subordinated Debentures
BNCCORP fully and unconditionally guarantees the Company's subordinated debentures.

Performance and Financial Standby Letters of Credit
As of December 31, 2010 and 2009, the Bank had outstanding $2.3 million and $481 thousand of performance standby letters of credit and $7.2 million and $13.3 million of financial standby letters of credit. Performance standby letters of credit are irrevocable obligations to the beneficiary on the part of the Bank to make payment on account of any default by the account party in the performance of a nonfinancial or commercial obligation. Financial standby letters of credit are irrevocable obligations to the beneficiary on the part of the Bank to repay money for the account of the account party or to make payment on account of any indebtedness undertaken by the account party, in the event that the account party fails to fulfill its obligation to the beneficiary. Under these arrangements, the Bank could, in the event of the account party's nonperformance, be required to pay a maximum of the amount of issued letters of credit. The Bank has recourse against the account party up to and including the amount of the performance standby letter of credit. The Bank evaluates each account party's creditworthiness on a case-by-case basis and the amount of collateral obtained varies and is based on management's credit evaluation of the account party.

NOTE 23. Related-Party/Affiliate Transactions

The Bank has entered into transactions with related parties, such as opening deposit accounts for and extending credit to, employees of the Company. The related party transactions have under terms substantially the same as those offered by the Bank to unrelated parties.

In the normal course of business, loans are granted to, and deposits are received from, executive officers, directors, principal stockholders and associates of such persons. The aggregate dollar amount of these loans was $674,000 and $1.8 million at December 31, 2010 and 2009, respectively. Originations in 2010 and 2009 totaled $375,000 and $425,000, respectively. Loan paydowns in 2010 and 2009 were $1.5 million and $818,000, respectively. The total amount of deposits received from these parties was $2.0 million and $1.4 million at December 31, 2010 and 2009, respectively. Loans to, and deposits received from, these parties were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collection.

The Federal Reserve Act limits amounts of, and requires collateral on, extensions of credit by the Bank to BNCCORP, and with certain exceptions, its non-bank affiliates. There are also restrictions on the amounts of investment by the Bank in stocks and other subsidiaries of BNCCORP and such affiliates and restrictions on the acceptance of their securities as collateral for loans by the Bank. As of December 31, 2010, BNCCORP and its affiliates were in compliance with these requirements.

NOTE 24. Income Taxes

The expense (benefit) for income taxes on operations consists of the following for the years ended December 31 (in thousands):

	2010	2009
Current:		
Federal	$ -	$ (4,138)
State	120	40
	120	(4,098)
Deferred:		
Federal	(7,222)	(2,899)
State	(1,658)	(1,165)
Valuation allowance	8,832	6,537
	(48)	2,473
Total	$ 72	$ (1,625)

The expense (benefit) for federal income taxes on operations expected at the statutory rate differs from the actual expense (benefit) for the years ended December 31 (in thousands):

	2010	2009
Tax (benefit) at 34% statutory rate	$ (7,478)	$ (6,936)
State taxes (net of Federal benefit)	(1,110)	(1,114)
Tax-exempt interest	(38)	(138)
Cash surrender values of bank-owned life insurance	(177)	(175)
Other, net	43	201
	(8,760)	(8,162)
Deferred tax valuation allowance	8,832	6,537
	$ 72	$ (1,625)

Temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities that result in significant portions of the Company's deferred tax assets and liabilities are as follows as of December 31 (in thousands):

	2010	2009
Deferred tax asset:		
Loans, primarily due to credit losses	$ 6,673	$ 4,701
Fraud loss on assets serviced by others	5,709	-
Acquired intangibles	257	279
Unrealized loss on securities available for sale	-	135
Net operating loss carryforwards	2,659	1,469
Alternative minimum tax credits	612	551
Other real estate owned	2,672	2,596
Other	335	536
Deferred tax asset	18,917	10,267
Deferred tax liability:		
Unrealized gain on securities available for sale	1,066	6
Discount accretion on securities	1,603	1,759
Leases	173	216
Premises and equipment	604	561
Other	259	199
Deferred tax liability	3,705	2,741
	15,212	7,526
Valuation allowance	(15,164)	(7,526)
Net deferred tax asset	$ 48	$ -

During 2010, the valuation allowance for net deferred tax assets was increased such that net deferred tax assets were reduced to $48,000. The valuation allowance was required because cumulative losses in the 36 month period ended December 31, 2010 exceeded earnings.

The Company is able to carry forward federal tax net operating losses aggregating $3.657 million as of December 31, 2010. The carry forward period is 20 years. The Company is able to carry forward state tax net operating losses aggregating $17.8 million as of December 31, 2010. The net operating losses expire between 2011 and 2031.

At December 31, 2010, the Company had an unrecognized tax benefit of $97,000. If this benefit was recognized, it would affect the Company's effective tax rate. The Company recognizes interest as a component of tax expense. We had approximately $13,000 of interest accrued at December 31, 2010 and no penalties. Interest included in tax expense for 2010 is approximately a benefit of $7,000.

The Company does not expect its unrecognized tax benefits to significantly increase or decrease within the next twelve months.

The Company files consolidated federal and unitary state income tax returns where allowed. Tax years ended December 31, 2007 through 2009 remain open to federal examination. During 2010, the Internal Revenue Service opened an examination of the Company's 2009 federal income tax return. All issues have been settled, but a final report has not yet been issued. The expected results of this examination did not have a material impact on our consolidated financial statements. Tax years ended December 31, 2006 through 2009 remain open to state examinations.

NOTE 25. Loss Per Share

The following table shows the amounts used in computing per share results (in thousands, except share and per share data):

Net loss per share was calculated as follows:

	2010	2009
Denominator for basic loss per share:		
Average common shares outstanding	3,281,719	3,261,831
Dilutive common stock options	0	11,891
Diluted common shares	3,281,719	3,273,722
Numerator:		
Net loss	$ (22,065)	$ (18,776)
Preferred stock costs	(1,333)	(1,254)
Net loss available to common shareholders	$ (23,398)	$ (20,030)
Basic loss per common share	$ (7.13)	$ (6.14)
Diluted loss per common share	$ (7.13)	$ (6.14)

At December 31, 2010 and 2009, options totaling 269,700 and 41,700, respectively, were outstanding but not included in the computation of diluted EPS because their exercise prices were higher than the average price of the Company's common stock. Exercise prices ranged from $3.00 to $7.38.

NOTE 26. Benefit Plans

BNCCORP has a qualified, tax-exempt 401(k) savings plan covering all employees of BNCCORP and its subsidiaries who meet specified age and service requirements. Under the plan, eligible employees may elect to defer up to 75% of compensation each year not to exceed the dollar limit set by law. At their discretion, BNCCORP and its subsidiaries may provide matching contributions to the plan. In 2010 and 2009, BNCCORP and its subsidiaries made matching contributions of up to 50% of eligible employee deferrals up to a maximum employer contribution of 5% of employee compensation. Generally, all participant contributions and earnings are fully and immediately vested. The Company makes its matching contribution during the first calendar quarter following the last day of each calendar year and an employee must be employed by the Company on the last day of the calendar year in order to receive the current year's employer match. The anticipated matching contribution is expensed monthly over the course of the calendar year based on employee contributions made throughout the year. The Company made matching contributions of $426,000 and $365,000 for 2010, and 2009, respectively. Under the investment options available under the 401(k) savings plan prior to January 28, 2008, employees could elect to invest their salary deferrals in BNCCORP common stock. At December 31, 2010, the assets in the plan totaled $15.7 million and included $157,000 (106,407 shares) invested in BNCCORP common stock. On January 28, 2008, the Company voluntarily delisted from the NASDAQ Global Market and deregistered its common stock under the Securities Exchange Act of 1934 (as amended). As a result, the participants are prohibited from making new investments of the Company's common stock in the plan.

NOTE 27. Commitments and Contingencies

Employment Agreements and Noncompete Covenants
The Company has entered into an employment agreement with its President and Chief Executive Officer (the President). However, the agreement governing the preferred stock issued to the Treasury department precludes payment of "golden parachutes" to senior executive officers of the Company so long as the preferred stock is outstanding.

Leases
The Bank has entered into operating lease agreements for certain facilities and equipment used in its operations. Rent expense for the years ended December 31, 2010 and 2009 was $1.729 million and $1.358 million, respectively, for facilities, and $40,000 and $49,000, respectively, for equipment and other items. At December 31, 2010, the total minimum annual base lease payments for operating leases were as follows (in thousands):

2011	$	665
2012		219
2013		166
2014		141
2015		144
Thereafter		1,822

NOTE 28. Share-Based Compensation

The Company has four share-based plans for certain key employees and directors whereby shares of common stock have been reserved for awards in the form of stock options or restricted stock awards. Under the 1995 Stock Incentive Plan, the aggregate number of options and shares granted cannot exceed 250,000 shares. Under the 2002 Stock Incentive Plan, the aggregate number of shares cannot exceed 125,000 shares. Under the 2006 Stock Incentive Plan, the aggregate number of shares cannot exceed 200,000 shares. Under the 2010 Stock Incentive Plan, the aggregate number of shares cannot exceed 250,000 shares. Pursuant to each plan, the compensation committee may grant options at prices equal to the fair value of the stock at the grant date.

Total shares available and maximum restricted shares available as of December 31, 2010 are as follows:

	1995 Stock Incentive Plan	2002 Stock Incentive Plan	2006 Stock Incentive Plan	2010 Stock Incentive Plan	Total
Total Shares Available	46,251	-	15,850	250,000	312,101
Maximum Restricted Shares Available	46,251	-	15,850	35,000	97,101

The Company recognized share-based compensation expense of $38,000 and $262,000 for the years ended December 31, 2010 and 2009, respectively, related to restricted stock.

The tax benefits associated with share-based compensation would have been approximately $2,000 and $56,000 for the years ended December 31, 2010 and 2009, respectively if the Company had not been in a full valuation allowance.

At December 31, 2010, the Company had $77,000 of unamortized restricted stock compensation. At December 31, 2009, the Company had $91,000 of unamortized restricted stock compensation. Restricted shares of stock granted generally have vesting and amortization periods of at least three years.

Following is a summary of restricted stock activities for the years ended December 31:

	2010		2009	
	Number Restricted Stock Shares	**Weighted Average Grant Date Fair Value**	**Number Restricted Stock Shares**	**Weighted Average Grant Date Fair Value**
Nonvested, beginning of year	8,500	$ 12.04	37,332	$ 12.35
Granted	15,000	1.61	-	-
Vested	(3,000)	11.93	(28,832)	12.44
Forfeited	-	-	-	-
Nonvested, end of year	20,500	4.42	8,500	12.04

The Company granted 240,000 stock options on March 17, 2010. The stock options have a two year vesting period and a ten year contractual term. The exercise price is equal to the market price on grant date, which was $3.00. The fair value of each share option is estimated on the date of grant using a Black-Scholes methodology with the assumptions noted below:

Expected volatility	32.56%
Dividend yield	0.00%
Risk-free interest rate – seven year treasury yield	3.201%
Expected life of stock option	7 years

The Company recognized share-based compensation expense of $111,000 and $0 for the years ended December 31, 2010 and 2009, respectively, related to share options. At December 31, 2010, the Company had $169,000 of unamortized compensation cost related to non-vested stock options granted.

BNC has a policy of issuing shares from treasury shares already held when options are exercised.

Following is a summary of fully vested stock options and options expected to vest as of December 31, 2010:

	Stock Options Outstanding	**Stock Options Currently Exercisable**	**Stock Options Vested and Expected to Vest**
Number	269,700	41,700	269,700
Weighted-average exercise price	$3.49	$6.20	$3.49
Weighted-average remaining contractual term	7.9 years	0.5 years	7.9 years

Following is a summary of stock option transactions for the years ended December 31:

	2010		2009	
	Options to Purchase Shares	Weighted Average Exercise Price	Options to Purchase Shares	Weighted Average Exercise Price
Outstanding, beginning of year	41,700	$ 6.20	44,200	$ 6.34
Granted	240,000	3.00	-	-
Exercised	-	-	-	-
Forfeited	(12,000)	3.00	(2,500)	8.75
Outstanding, end of year	269,700	$ 3.49	41,700	$ 6.20
Exercisable, end of year	41,700	$ 6.20	41,700	$ 6.20
Weighted average fair value of				
Granted	$ 1.23		$ -	
Exercised	$ -		$ -	
Forfeited	$ 1.23		$ 3.91	

Following is a summary of the status of options outstanding at December 31, 2010:

	Outstanding Options			Exercisable Options	
	Number	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Options with exercise prices ranging from:					
$3.00 to $3.00	228,000	9.3 years	$ 3.00	-	$ -
$5.94 to $7.38	41,700	0.5 years	6.20	41,700	6.20
	269,700			41,700	

NOTE 29. Condensed Financial Information-Parent Company Only

Condensed financial information of BNCCORP on a parent company only basis is as follows:

Parent Company Only
Condensed Balance Sheets
As of December 31
(In thousands, except per share data)

	2010	2009
Assets:		
Cash and cash equivalents	$ 2,377	$ 4,339
Investment securities available for sale	-	1,463
Investment in subsidiaries	57,807	77,894
Receivable from subsidiaries	883	159
Other	473	7,404
Total assets	$ 61,540	$ 91,259
Liabilities and stockholders' equity:		
Subordinated debentures	$ 23,120	$ 23,118
Payable to subsidiaries	43	7,135
Accrued expenses and other liabilities	3,664	1,781
Total liabilities	26,827	32,034
Preferred stock, $.01 par value. Authorized 2,000,000 shares:		
Preferred Stock - 5% Series A 20,093 shares issued and outstanding;	19,411	19,187
Preferred Stock - 9% Series B 1,005 shares issued and outstanding;	1,075	1,098
Common stock, $.01 par value – Authorized 35,000,000 shares; 3,304,339 and 3,290,219 shares issued and outstanding	33	33
Capital surplus – common stock	27,036	26,885
Retained earnings	(7,322)	16,078
Treasury stock (364,314 and 363,434 shares, respectively)	(5,069)	(5,068)
Accumulated other comprehensive income (loss), net of income taxes	(451)	1,012
Total stockholders' equity	34,713	59,225
Total liabilities and stockholders' equity	$ 61,540	$ 91,259

Parent Company Only
Condensed Statements of Operations
For the Years Ended December 31
(In thousands)

	2010	2009
Income:		
Management fee income	$ 1,596	$ 1,555
Interest	27	1,376
Gain on sale of securities	2,150	-
Other	38	41
Total income	3,811	2,972
Expenses:		
Interest	1,279	1,292
Salaries and benefits	708	749
Legal and other professional	542	534
Depreciation and amortization	1	1
Other	677	958
Total expenses	3,207	3,534
Income (loss) before income tax benefit and equity in income of subsidiaries	604	(562)
Income tax expense	(582)	(783)
Income (loss) before equity in income of subsidiaries	22	(1,345)
Equity in loss of subsidiaries	(22,087)	(17,431)
Net loss	$ (22,065)	$ (18,776)

Parent Company Only
Condensed Statements of Cash Flows
For the Years Ended December 31
(In thousands)

	2010	2009
Operating activities:		
Net loss	$ (22,065)	$ (18,776)
Adjustments to reconcile net loss to net cash used in operating activities -		
Equity in undistributed loss of subsidiaries	22,087	17,431
Depreciation and amortization	3	5
Impairment of goodwill	-	154
Share based compensation	150	257
Other noncash expense	-	105
Deferred income taxes	-	352
Change in prepaid expenses and other receivables	6,206	(6,950)
Net realized gain on sale of investment securities	(2,150)	-
Change in accrued expenses and other liabilities	(6,343)	5,961
Net cash used in operating activities	(2,112)	(1,461)
Investing activities:		
Increase in investment in subsidiaries	(2,000)	(15,001)
Proceeds from sale of investment securities	2,150	-
Net cash (used in) provided by investing activities	150	(15,001)
Financing activities:		
Proceeds from issuance of preferred stock	-	20,093
Payment of preferred stock dividends	-	(1,058)
Net cash provided by financing activities	-	19,035
Net increase (decrease) in cash and cash equivalents	(1,962)	2,573
Cash and cash equivalents, beginning of year	4,339	1,766
Cash and cash equivalents, end of year	$ 2,377	$ 4,339
Supplemental cash flow information:		
Interest paid	$ -	$ 1,149
Income taxes paid (received)	$ (5,972)	$ 2,310

NOTE 30. Subsequent Events

The Company has evaluated subsequent events from the balance sheet date through March 22, 2011, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.

CORPORATE DATA

Investor Relations

Gregory K. Cleveland, CPA
President/CEO
602-852-3526

Timothy J. Franz, CPA
Chief Financial Officer
612-305-2213

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Facsimile (701) 222-3653

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Annual Meeting

The 2011 annual meeting of stockholders will be held on Wednesday, June 15, 2011 at 8:30 a.m. (Central Daylight Time) at BNC National Bank, Second Floor Conference Room, 322 East Main Avenue, Bismarck , ND 58501.

Independent Public Accountants

KPMG LLP
233 South 13th Street
Suite 1600
Lincoln, NE 68508

Securities Listing

BNCCORP, INC.'s common stock is traded on the OTC Markets under the symbol: "BNCC." There were 72 record holders of the Company's common stock at March 11, 2011.

COMMON STOCK PRICES

For the Years Ended December 31,

	2010(1)		2009(1)	
	High	Low	High	Low
First Quarter	$4.00	$1.80	$8.50	$5.30
Second Quarter	$3.19	$1.80	$8.50	$5.60
Third Quarter	$2.25	$1.40	$8.00	$5.00
Fourth Quarter	$2.00	$1.41	$5.50	$1.95

(1) The quotes represent the high and low closing sales prices as reported by OTC Markets.

Stock Transfer Agent and Registrar

American Stock Transfer & Trust Company
59 Maiden Lane, Plaza Level
New York, NY 10038
(800) 937-5449

DIRECTORS
BNCCORP, INC.

Mark W. Sheffert
Chairman of the Board of BNCCORP, INC.
Chairman and Chief Executive Officer, Manchester Companies, Inc.

Gregory K. Cleveland, CPA
President and Chief Executive Officer

Tracy Scott, CPA
Retired Co-Founder of BNCCORP, INC.

Bradley D. Bonga
Founder and President/CEO
Bonga and Associates, LLC

Gaylen Ghylin, CPA
EVP, Secretary and CFO
Tiller Corporation d/b/a Barton Sand & Gravel Co., Commercial Asphalt Co. and Barton Enterprises, Inc.

Richard M. Johnsen, Jr.
Chairman of the Board and Chief Executive Officer, Johnsen Trailer Sales, Inc.

Michael O'Rourke
Attorney / Author

Stephen H. Roman
Partner
FirstStrategic LLC

DIRECTORS
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Gregory K. Cleveland
Shawn Cleveland
Timothy J. Franz
David Hoekstra
Mark E. Peiler
Scott Spillman

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Bismarck, ND 58501

Bismarck South
219 South 3rd Street
Bismarck, ND 58504

Bismarck North
801 East Century Avenue
Bismarck, ND 58503

Primrose Assisted Living Apartments
1144 College Drive
Bismarck, ND 58501

Waterford on West Century
1000 West Century Avenue
Bismarck, ND 58503

Crosby
107 North Main Street
Crosby, ND 58730

Garrison
92 North Main
Garrison, ND 58540

Kenmare
103 1st Avenue SE
Kenmare, ND 58746

Linton
104 North Broadway
Linton, ND 58552

Stanley
210 South Main
Stanley, ND 58784

Watford City
205 North Main
Watford City, ND 58854

Minneapolis
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733 Marquette Avenue South
Minneapolis, MN 55402

Golden Valley
650 Douglas Drive
Golden Valley, MN 55422

The Heathers Estate
2900 North Douglas Drive
Crystal, MN 55422

The Heathers Manor
3000 North Douglas Drive
Crystal, MN 55422

Perimeter
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Scottsdale, AZ 85255

Mortgage Banking Branches:

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8330 East Hartford Drive
Scottsdale, AZ 85255

Wichita
7200 West 13th
Wichita, KS 67212

Wichita
1718 North Webb Road
Wichita, KS 67206

Andover
511 North Andover Road
Andover, Kansas 67002

Overland Park
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Overland Park, KS 66211

Topeka
2110 SW Belle Avenue
Topeka, KS 66614

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Davenport, IA 52806

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President and Chief Executive Officer

Timothy J. Franz, CPA
Chief Financial Officer

Shawn Cleveland, CPA
Chief Operating Officer, BNC National Bank

Dave Hoekstra, CPA
Chief Credit Officer and President – BNC National Bank, North Dakota Market

Mark E. Peiler, CFA
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OTC Markets