2011 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 15 locations. BNC also conducts mortgage banking from 12 locations in Arizona, Minnesota, Illinois, Kansas, Nebraska and Missouri.

GREGORY K. CLEVELAND
President and Chief Executive Officer

"BNC has made significant progress in remediating challenges resulting from the deep economic downturn that began a few years ago."

To Our Stockholders, Customers, Employees and Friends:

Since my last letter to you in the spring of 2011, BNC has made significant progress in remediating challenges resulting from the deep economic downturn that began a few years ago. We have improved asset quality, delivered profitable results, and taken steps to build our capital base. From this strengthened position, we are looking forward to serving our customers and community and growing our business.

We made significant improvements in our credit quality, as nonperforming assets decreased by $14.2 million, or 46%, and nonperforming loans decreased by $11.7 million, or 65%, during 2011. As result of these improvements, we were able to exit our formal operating agreement with our primary regulator. Gaining greater operating flexibility and control over our business decisions is a major accomplishment.

We also announced a capital offering that is expected raise $17 million of common equity. As 2011 ended, our tangible common equity was unacceptably low, less than 3.2% of assets. Our tangible common equity ratio improves to approximately 5.50% at the end of 2011 when capital is adjusted on a pro forma basis for the offering. In addition, we have deferred interest and dividend payments on the obligations of our holding company since 2010. While deferring payments granted us leeway to address other challenges aggressively, it is important that we honor our obligations, and raising capital will provide the assurance that we can once again meet these obligations. Raising capital is imperative, and exceptionally difficult, for many community banks. Our offering is fully subscribed and the proceeds are being held in escrow pending regulatory approval, which is expected in the second or third quarter of 2012.

Focusing on Critical Priorities and Emphasizing Community Banking

For several periods, we have stated our highest priorities are credit quality, liquidity and capital. We have managed these priorities admirably as nonperforming loans are 0.76% of assets entering March 2012, the Bank's total risk-based capital exceeds 18% and our access to financing has improved significantly. Our focus on these important matters is mission critical. We will continue to address these matters aggressively.

A renewed focus on community banking is integral to our future. At their best, community banks understand the needs of their markets better than super-regional or national institutions. Community banks also play an active role in civic events and foster local growth initiatives. Active community bankers are good for business because they know more people and attend to their needs. BNC has always supported our people and our communities. Our people are currently involved in more than 40 civic organizations and we expect BNC's community involvement to expand in 2012.

We have quality people who are dedicated to improving BNC and our service to customers, and enhancing our talent pool is a perpetual priority. I am proud of our people and they should be proud of our accomplishments. To keep moving forward, we must continue to motivate and train our current professionals while we add new talent to this team.

Improving earnings will be a challenge for many community banks due to low interest rates and regulatory pressure on revenues and costs. We are relatively satisfied with 2011 net income of $4.2 million, which generated a return on assets of 61 basis points and a return on common equity of 15.8%. To grow our earnings we need to balance discipline and willingness to innovate. In recent years we have incubated our SBA lending team, which generated $1.4 million of revenue in 2011, and our mortgage banking operations, which generated $11.3 million of revenue in 2011. We are looking for similar opportunities to improve revenues and profits while we grow loans and deposits in the North Dakota banking operations.

The expansion of new regulations in reaction to the "Great Recession" has increased regulatory risk and burden. For the foreseeable future, the new regulatory environment will weigh heavily on financial institutions. We are well equipped to address this challenge, but it will require constant diligence.

Outlook for 2012 and Prospects for Growth

Economic indicators currently appear to be contradictory. High unemployment, the soft housing market, high consumer debt in this country, and troubled governmental debt globally present very real and very large economic hurdles. Despite these circumstances, the economic growth in the United States seems to be improving. With this conflicting set of economic forces, our goal is to balance caution and the desire to capitalize on opportunity.

Fortunately, economic growth in our key geographic area of North Dakota is robust. We believe this backdrop provides an excellent opportunity for us to grow loans and deposits. Energy and agriculture – industries we know well – have strong tailwinds in this region. We want to expand our presence in these industries. Consumers in North Dakota are experiencing increasing wealth. We want to help them accomplish their goals by delivering traditional banking products and highly specialized services with our wealth management professionals.

We are proud of our recent accomplishments and are well positioned to grow. Capitalizing on the opportunities and managing risk will require the right balance. I am confident we are up to the task.

Sincerely,

GREGORY K. CLEVELAND
President and Chief Executive Officer

BNCCORP, INC.
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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,				
	2011	2010	2009	2008	2007[(1)]
Income Statement Data from Continuing Operations:					
Total interest income	$ 25,749	$ 33,510	$ 44,588	$ 46,026	$ 44,241
Total interest expense	6,272	10,238	14,899	19,215	21,994
Net interest income	19,477	23,272	29,689	26,811	22,247
Provision for credit losses	1,625	5,750	27,000	7,750	3,750
Non-interest income	20,237	23,973	16,013	10,395	3,853
Fraud loss on assets serviced by others	-	26,231	-	-	-
Non-interest expense, excluding fraud loss on assets serviced by others	33,859	37,257	39,103	26,501	28,147
Income tax expense (benefit)	22	72	(1,625)	737	(2,728)
Income (loss) from continuing operations	$ 4,208	$ (22,065)	$ (18,776)	$ 2,218	$ (3,069)[(1)]
Balance Sheet Data: (at end of period)					
Total assets	$ 665,158	$ 747,069	$ 868,083	$ 861,498	$ 699,591
Investments securities available for sale	242,630	137,032	212,661	209,857	122,899
Federal Reserve Bank and Federal Home Loan Bank stock	2,750	2,862	3,048	5,989	4,918
Participating interests in mortgage loans	-	4,888	38,534	28,584	24,357
Loans held for sale-mortgage banking	68,622	29,116	24,130	13,403	-
Loans and leases held for investment, net of unearned income	293,211	350,501	517,108	542,753	497,556
Other loans held for sale, net	-	70,501	-	-	-
Allowance for credit losses	(10,630)	(14,765)	(18,047)	(8,751)	(6,599)
Total deposits	576,255	661,111	755,963	675,321	541,874
Core deposits	516,436	594,152	640,169	575,637	541,874
Short-term borrowings	8,635	16,329	10,190	16,844	5,365
Federal Home Loan Bank advances	-	-	15,000	84,500	61,400
Other borrowings	-	-	-	-	-
Guaranteed preferred beneficial interests in Company's subordinated debentures	22,427	24,134	22,890	23,025	23,075
Common stockholders' equity	21,180	16,835	36,980	53,947	59,730
Book value per common share outstanding	$ 6.42	$ 5.09	$ 11.24	$ 16.35	$ 17.11
Tangible book value	$ 6.42	$ 5.09	$ 11.24	$ 16.23	$ 16.99
Earnings Performance / Share Data from Continuing Operations:					
Return (loss) on average total assets	0.61%	(2.79)%	(2.09)%	0.28%	(0.47)%
Return (loss) on average common stockholders' equity	15.77%	(90.47)%	(38.88)%	3.85%	(5.25)%
Efficiency ratio	85.26%	134.38%	85.56%	71.22%	107.85%
Net interest margin	3.11%	3.20%	3.58%	3.64%	3.81%
Net interest spread	2.89%	3.14%	3.37%	3.46%	3.31%
Basic earnings (loss) per common share	$ 0.86	$ (7.13)	$ (6.14)	$ 0.67	$ (0.89)
Diluted earnings (loss) per common share	$ 0.86	$ (7.13)	$ (6.14)	$ 0.67	$ (0.89)
Average common shares outstanding	3,282,182	3,281,719	3,261,831	3,291,697	3,456,993
Average common and common equivalent shares	3,282,182	3,281,719	3,273,722	3,319,225	3,515,852
Shares outstanding at year end	3,301,007	3,304,339	3,290,219	3,299,163	3,491,337
Other Key Ratios					
Nonperforming assets to total assets	2.45%	4.09%	4.97%	3.84%	0.77%
Nonperforming loans to total assets	0.93%	2.39%	4.13%	2.66%	0.77%
Nonperforming loans to loans and leases held for investment	2.10%	5.10%	6.94%	4.22%	1.09%
Net loan charge-offs to average loans and leases held for investment	(1.780)%	(1.530)%	(3.235)%	(1.066)%	(0.129)%
Allowance for credit losses to total loans	2.94%	3.84%	3.11%	1.50%	1.26%
Allowance for credit losses to total nonperforming loans	172%	83%	50%	38%	122%

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

Quarterly Financial Data

	2011				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	YTD
Interest income	$ 6,907	$ 6,256	$ 6,199	$ 6,387	$ 25,749
Interest expense	1,747	1,560	1,587	1,378	6,272
Net interest income	5,160	4,696	4,612	5,009	19,477
Provision for credit losses	600	500	275	250	1,625
Net interest income after provision for credit losses	4,560	4,196	4,337	4,759	17,852
Non-interest income	4,036	4,717	6,074	5,410	20,237
Non-interest expense	8,023	8,262	8,819	8,755	33,859
Income before income taxes	573	651	1,592	1,414	4,230
Income tax expense (benefit)	-	2	(2)	22	22
NET INCOME	$ 573	$ 649	$ 1,594	$ 1,392	$ 4,208
Preferred stock costs	(339)	(345)	(354)	(356)	(1,394)
Net income available to common shareholders	$ 234	$ 304	$ 1,240	$ 1,036	$ 2,814
Basic earnings per common share	$ 0.07	$ 0.09	$ 0.38	$ 0.31	$ 0.86
Diluted earnings per common share	$ 0.07	$ 0.09	$ 0.38	$ 0.31	$ 0.86
Average common shares:					
Basic	3,283,839	3,282,426	3,289,756	3,289,756	3,282,182
Diluted	3,283,839	3,282,426	3,289,756	3,289,756	3,282,182

	2010				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	YTD
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

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 North Dakota, Minnesota and Arizona from 15 locations. The Company also conducts mortgage banking from 12 locations in Arizona, Minnesota, Illinois, 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 with our primary market focus in North Dakota. We also have complimentary banking activities in Minnesota and Arizona. Key elements of our operating strategy are:

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

We also look for opportunities to expand opportunistically. For example, in recent years we have expanded our mortgage banking operations as low interest rates and government support for the housing industry has provided favorable conditions for mortgage banking. As a result, mortgage banking has made positive contributions in recent periods. The continuation of these recent favorable mortgage banking conditions is subject to uncertainty and the industry is also experiencing increasing regulatory oversight which is having a consolidating effect on the industry.

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):

	2011	2010
SELECTED INCOME STATEMENT DATA		
Interest income	$ 25,749	$ 33,510
Interest expense	6,272	10,238
Net interest income	19,477	23,272
Provision for credit losses	1,625	5,750
Non-interest income	20,237	23,973
Fraud loss on assets serviced by others	-	26,231
Non-interest expense, excluding fraud loss on assets serviced by others	33,859	37,257
Income (loss) before income taxes	4,230	(21,993)
Income tax expense	22	72
Net income (loss)	4,208	(22,065)
Preferred stock costs	(1,394)	(1,333)
Net income (loss) available to common shareholders	$ 2,814	$ (23,398)
EARNINGS PER SHARE DATA		
Basic earnings (loss) per common share	$ 0.86	$ (7.13)
Diluted earnings (loss) per common share	$ 0.86	$ (7.13)

The following is an overview of recent periods:

- In 2011, operations were characterized by lower non-performing assets and related provisions for losses, improved capital ratios at the Bank and profitable results from operations.
- Net interest income has been decreasing due to reduced assets and lower interest rates. For more information see discussion of net interest income that follows in the MD&A.
- Non-interest income has been significantly impacted by gains on sales of loans and mortgage banking revenues. For more information see discussion of non-interest income that follows in the MD&A.
- Non-interest expenses were significantly impacted by the fraud loss on assets serviced by others in 2010. See Note 4 of our Consolidated Financial Statements.
- In November 2010, we announced an agreement to sell certain loans, other assets and deposits in our Arizona and Minnesota markets. This sale was consummated in March 2011. See Note 3 of our Consolidated Financial Statements.
- In recent years the ratio of our common stockholders' equity to total assets has been very low when compared to peers. In early 2012, we announced agreements to raise approximately $17 million of common equity which will improve this ratio and will be used for general corporate purposes which may include repayment of preferred stock. The agreements to raise capital are subject to regulatory approvals and satisfaction of other customary closing conditions.

General

Net income in 2011 was $4.208 million, or $0.86 per diluted share, compared to a net loss of $(22.065) million, or $(7.13) per diluted share in 2010.

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):

	For the Year ended December 31, 2011			For the Year ended December 31, 2010			For the Year ended December 31, 2009		
	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
Assets									
Federal funds sold/interest-bearing due from	$ 63,570	$ 161	0.25%	$ 47,470	$ 111	0.23%	$ 5,755	$ 9	0.16%
Taxable investments	204,463	7,606	3.72%	167,572	8,631	5.15%	226,309	14,397	6.36%
Tax-exempt investments	9,123	331	3.63%	2,111	93	4.41%	8,165	409	5.01%
Loans held for sale-mortgage banking	33,317	1,342	4.03%	29,039	1,263	4.35%	23,570	1,182	5.01%
Participating interests in mortgage loans	1,101	45	4.09%	20,144	665	3.30%	29,683	1,312	4.42%
Loans and leases held for investment	328,091	16,264	4.96%	478,492	22,747	4.75%	547,336	27,279	4.98%
Allowance for credit losses	(12,754)	-		(17,201)	-		(11,962)	-	
Total interest-earning assets	626,911	25,749	4.11%	727,627	33,510	4.61%	828,856	44,588	5.38%
Non-interest-earning assets:									
Cash and due from banks	8,997			9,929			9,749		
Other	53,360			53,146			61,611		
Total assets	$ 689,268			$ 790,702			$ 900,216		
Liabilities and Stockholders' Equity									
Deposits:									
Interest checking and money market accounts	$ 253,054	940	0.37%	$ 282,880	1,729	0.61%	$ 266,537	2,379	0.89%
Savings	12,655	13	0.10%	11,156	11	0.10%	11,685	13	0.11%
Certificates of deposit:									
Under $100,000	139,254	2,812	2.02%	186,978	5,426	2.90%	246,888	7,622	3.09%
$100,000 and over	71,432	1,008	1.41%	99,141	1,642	1.66%	125,372	2,372	1.89%
Total interest-bearing deposits	476,395	4,773	1.00%	580,155	8,808	1.52%	650,482	12,386	1.90%
Borrowings:									
Short-term borrowings	15,583	132	0.85%	11,163	73	0.65%	17,953	179	1.00%
FHLB advances	11	-	0.00%	2,899	112	3.86%	51,738	1,078	2.08%
Other borrowings	-	-	0.00%	10	1	10.00%	58	3	5.17%
Subordinated debentures	23,437	1,367	5.83%	23,491	1,244	5.30%	22,686	1,253	5.52%
Total interest-bearing liabilities	515,426	6,272	1.22%	617,718	10,238	1.66%	742,917	14,899	2.01%
Non-interest-bearing demand accounts	124,208	-	0.00%	117,459	-	0.00%	77,736	-	0.00%
Total deposits and interest-bearing liabilities	639,634			735,177			820,653		
Other non-interest-bearing liabilities	11,201			9,272			8,679		
Total liabilities	650,835			744,449			829,332		
Stockholders' equity	38,433			46,253			70,884		
Total liabilities and stockholders' equity	$ 689,268			$ 790,702			$ 900,216		
Net interest income		$ 19,477			$ 23,272			$ 29,689	
Net interest spread			2.89%			2.95%			3.37%
Net interest margin			3.11%			3.20%			3.58%
Ratio of average interest-earning assets to average interest-bearing liabilities	121.63%			117.79%			111.57%		

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

	For the Years Ended December 31, 2011 Compared to 2010			For the Years Ended December 31, 2010 Compared to 2009		
	Change Due to			Change Due to		
	Volume	Rate	Total	Volume	Rate	Total
Interest Earned on Interest-Earning Assets						
Federal funds sold/interest-bearing due from	$ 40	$ 10	$ 50	$ 95	$ 7	$ 102
Taxable investments	1,667	(2,692)	(1,025)	(3,326)	(2,440)	(5,766)
Tax-exempt investments	257	(19)	238	(272)	(44)	(316)
Loans held for sale–mortgage banking	177	(98)	79	251	(170)	81
Participating interests in mortgage loans	(748)	128	(620)	(362)	(285)	(647)
Loans held for investment	(7,419)	936	(6,483)	(3,315)	(1,217)	(4,532)
Total increase (decrease) in interest income	(6,026)	(1,735)	(7,761)	(6,929)	(4,149)	(11,078)
Interest Expense on Interest-Bearing Liabilities						
Interest checking and money market accounts	(167)	(622)	(789)	138	(788)	(650)
Savings	2	-	2	(1)	(1)	(2)
Certificates of Deposit:						
Under $100,000	(1,193)	(1,421)	(2,614)	(1,761)	(435)	(2,196)
$100,000 and over	(415)	(219)	(634)	(458)	(272)	(730)
Short-term borrowings	34	25	59	(56)	(50)	(106)
FHLB advances	(56)	(56)	(112)	(1,474)	508	(966)
Other borrowings	-	(1)	(2)	(4)	2	(2)
Subordinated debentures	(3)	126	123	45	(54)	(9)
Total increase (decrease) in interest expense	(1,798)	(2,168)	(3,966)	(3,571)	(1,090)	(4,661)
Increase (decrease) in net interest income	$ (4,228)	$ 433	$ (3,795)	$ (3,358)	$ (3,059)	$ (6,417)

Net interest income was $19.477 million in 2011 compared to $23.272 million in 2010, a decrease of $3.795 million or 16.3%. The net interest margin decreased to 3.11% for the year ended December 31, 2011 from 3.20% in 2010.

In 2011, lower balances of assets and liabilities combined to reduce net interest income. Earning assets and interest bearing liabilities decreased in 2011 due to the sale of loans described in Note 3 of our Consolidated Financial Statements. We also stopped buying participating interests. Investments increased as we deployed liquidity built up in prior periods. In 2011, we were able to reduce interest expense more than interest income was impacted by the low rate environment. Our ability to lower our cost of funds in the future is relatively limited because interest rates are currently low.

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% 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. During 2010, cash balances were elevated 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.

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) 2011 – 2010		
	2011	2010	$	%	
Bank charges and service fees	$ 2,218	$ 2,533	$ (315)	(12) %	(a)
Wealth management revenues	1,282	2,133	(851)	(40) %	(b)
Mortgage banking revenues	11,285	13,424	(2,139)	(16) %	(c)
Gains (losses) on sales of loans, net	1,427	371	1,056	285 %	(d)
Gains on sales of securities, net	2,830	4,390	(1,560)	(36) %	(e)
Other	1,195	1,122	73	7 %	(f)
Total non-interest income	$ 20,237	$ 23,973	$ (3,736)	(16) %	

(a) Bank charges and service fees decreased in 2011 primarily due to the sale of deposits discussed in Note 3 of our Consolidated Financial Statements.
(b) Wealth management revenues decreased as we stopped offering two products in 2010 when we discontinued being an ESOP trustee and managing documents on insurance products sold by others. These products no longer fit our operating parameters.
(c) Mortgage banking revenues have been significant in recent years because we have been expanding these operations. 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. Revenues in 2010 were higher than 2011 due to an extraordinary volume of refinance activity in the second half of 2010.
(d) In 2010, we began to sell SBA loans at gains and continued these transactions in 2011. The secondary market is currently acquiring these assets and selling the loans is an efficient use of capital. We anticipate more sales of SBA loans in the foreseeable future.
(e) Gains on sales of securities, net vary depending on the nature and volume of transactions.
(f) In 2011, we received $300 thousand of return on investment in a SBIC fund. In 2010, we sold a branch at a gain of $403 thousand.

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) 2011– 2010		
	2011	2010	$	%	
Salaries and employee benefits	$ 14,972	$ 16,080	$ (1,108)	(7) %	(a)
Professional services	4,307	5,068	(761)	(15) %	(b)
Other real estate costs	2,295	2,707	(412)	(15) %	(c)
Occupancy	2,028	2,885	(857)	(30) %	(d)
Data processing fees	2,673	2,697	(24)	(1) %	
Regulatory costs	1,742	1,951	(209)	(11) %	(e)
Marketing and promotion	1,559	1,372	187	14 %	(f)
Depreciation and amortization	1,172	1,333	(161)	(12) %	
Office supplies and postage	590	603	(13)	(2) %	
Fraud loss on assets serviced by others	-	26,231	(26,231)	100 %	(g)
Other	2,521	2,561	(40)	(2) %	
Total non-interest expense	$ 33,859	$ 63,488	$ (29,629)	(47) %	
Efficiency ratio	85.26%	134.38%	(49.12)%		

(a) Salaries decreased in 2011 due to the divesture discussed in Note 3 of our Consolidated Financial Statements. We have also been managing costs downward.

(b) Professional services have been elevated since April 2010 due to the costs incurred to investigate and litigate the fraud loss discussed in Note 4 of our Consolidated Financial Statements. In recent years we have also experienced increased legal fees associated with problem credits. Professional services required by mortgage banking operations will vary depending on the volume of originations.

(c) 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.

(d) Occupancy decreased due the divestiture discussed in Note 3 of our Consolidated Financial Statements. We also relocated certain operations to less expensive space in an effort to manage costs downward.

(e) Regulatory costs related to FDIC insurance decreased due to lower deposit balances after the divestiture discussed in Note 3 of our Consolidated Financial Statements.

(f) Marketing and promotion costs increased in our mortgage banking operations.

(g) For information related to the fraud loss see Note 4 of our Consolidated Financial Statements.

Income Tax Expense

Tax expense was $22 thousand in 2011 as we recognized expense for miscellaneous tax liabilities. The Company has net operating loss carry-forwards aggregating $6.099 million for federal tax purposes. The Company virtually has a full valuation allowance for deferred tax assets and tax loss carry-forwards. Tax expense in 2010 was $72 thousand, or 0.3% of pre-tax losses.

Financial Condition

Assets

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

	As of December 31,		Increase (Decrease) 2011 – 2010		
	2011	2010	$	%	
Cash and cash equivalents	$ 19,296	$ 112,847	$ (93,551)	(83) %	(a)
Investment securities available for sale	242,630	137,032	105,598	77 %	(b)
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	2,750	2,862	(112)	(4) %	(c)
Participating interests in mortgage loans	-	4,888	(4,888)	(100) %	(d)
Loans held for sale-mortgage banking	68,622	29,116	39,506	136 %	(e)
Loans and leases held for investment, net	282,581	335,736	(53,155)	(16) %	(f)
Other loans held for sale	-	70,501	(70,501)	100 %	(g)
Other real estate, net	10,145	12,706	(2,561)	(20) %	(h)
Premises and equipment, net	16,035	16,684	(649)	(4) %	
Interest receivable	2,411	2,138	273	13 %	(i)
Other assets	20,688	19,790	898	5 %	
Premises and equipment held for sale, net	-	2,769	(2,769)	100 %	(j)
Total assets	$ 665,158	$ 747,069	$ (81,911)	(11) %	

(a) In 2011 we used liquidity built up in prior periods to finance the sale of deposits. We also deployed remaining amounts to improve earnings. Cash balances can also vary significantly on a daily basis.
(b) In 2011, investments increased as we invested liquidity built up in prior periods.
(c) Investments in these stocks are mandated by third parties.
(d) Participating interests in mortgage loans decreased as we exited this line of business in 2011 when the cost of insuring third party servicers became prohibitively expensive. See Note 4 of our Consolidated Financial Statements for a discussion of the fraud perpetrated by a third party.
(e) Mortgage banking loans held for sale have recently increased as investors in mortgage loans became backlogged when the volume of mortgage loans refinanced increased late in 2011.
(f) Loans and leases held for investment have decreased as we have attempted to manage our credit exposure by reducing loans outstanding.
(g) In November 2010, we entered into an agreement to sell certain loans. The sale was consummated in March 2011. See Note 3 of our Consolidated Financial Statements.
(h) Other real estate decreased as reducing problem assets has been an area of focus in recent years. See Note 10 of our Consolidated Financial Statements.
(i) Accrued interest receivable increased due to higher balances of investments, partially offset by lower accrued interest on loans.
(j) These assets decreased when the divestiture discussed in Note 3 of our Consolidated Financial Statements was consummated.

Investment Securities Available for Sale

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

	December 31,			
	2011		2010	
	Amortized cost	Estimated fair market value	Amortized cost	Estimated fair market value
U.S. government agency mortgage-backed securities guaranteed by GNMA	$ 57,912	$ 59,300	$ 965	$ 1,000
U.S. government agency mortgage-backed securities issued by FNMA	6,004	6,171	1,863	1,978
Collateralized mortgage obligations guaranteed by GNMA/VA	127,551	127,547	89,056	89,689
Collateralized mortgage obligations issued by FNMA or FHLMC	13,169	13,321	930	997
Other collateralized mortgage obligations	11,179	11,487	39,518	41,255
State and municipal bonds	22,670	24,804	1,911	2,113
Total investments	$ 238,485	$ 242,630	$ 134,243	$ 137,032

There were no securities that management concluded were other-than-temporarily impaired in either 2011 or 2010.

The following table presents contractual maturities for securities available for sale and yields thereon at December 31, 2011 (dollars are in thousands):

	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%	$ 253	7.43%	$ 57,659	2.78%	$ 57,912	2.80%
U.S. government agency mortgage-backed securities issued by FNMA(2) (3)	-	0.00%	-	0.00%	-	0.00%	6,004	4.65%	6,004	4.65%
Collateralized mortgage obligations guaranteed by GNMA/VA(2) (3)	-	0.00%	-	0.00%	-	0.00%	127,551	2.62%	127,551	2.62%
Collateralized mortgage obligations issued by FNMA or FHLMC(2) (3)	-	0.00%	-	0.00%	527	7.35%	12,643	2.18%	13,169	2.39%
Other collateralized mortgage obligations(2) (3)	-	0.00%	-	0.00%	-	0.00%	11,178	7.67%	11,179	7.67%
State and municipal bonds(2)	-	0.00%	-	0.00%	1,433	7.95%	21,237	5.29%	22,670	5.46%
Total book value of investment securities	$ -	0.00%	$ -	0.00%	$ 2,213	7.75%	$ 236,272	3.17%	$ 238,485	3.21%
Unrealized holding gain on securities available for sale									4,145	
Total investment in securities available for sale									$ 242,630	3.15%

(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, 2011, we had $242.6 million of available-for-sale securities in the investment portfolio compared to $137.0 at December 31, 2010.

In 2011, investment securities increased as cash balances built up in prior periods were utilized in order to increase income from earning assets. Net unrealized gains increased as of December 31, 2011 as compared to December 31, 2010 due to the general decline in market interest rates. During 2011 we realized $2.830 million of net gains on sales of securities. While these gains can vary from period to period, we have been capitalizing on conditions that have been increasing the value of mortgage based investment portfolios.

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 spreads, 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.

At December 31, 2011, we held no securities, other than U.S. Government Agency mortgage-backed securities and collateralized mortgage obligations that exceeded 10% of stockholders' equity. A 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, 2011 and 2010, and $1.0 million and $1.1 million of FHLB of Des Moines stock as of December 31, 2011 and 2010, respectively.

Loans

The following table presents our loan portfolio (dollars are in thousands):

	2011		2010		2009		2008		2007	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Loans held for sale-mortgage banking	$ 68,622	100.0	$ 29,116	29.2	$ 24,130	100.0	$ 13,403	100.0	$ -	-
Other loans held for sale	-	-	70,501	70.8	-	-	-	-	-	-
Loans held for sale, net	68,622	100.0	99,617	100.0	24,130	100.0	13,403	100.0	-	-
Commercial and industrial	119,704	40.8	130,052	37.1	235,069	45.4	253,172	46.6	204,206	41.0
Commercial real estate	115,704	39.4	153,919	43.9	151,855	29.3	142,586	26.3	93,988	18.9
Consumer	23,038	7.9	25,841	7.4	34,439	6.7	39,089	7.2	33,128	6.7
Land and land development	33,881	11.6	40,340	11.5	96,050	18.6	107,797	19.9	165,391	33.2
Construction	1,014	0.3	646	0.2	277	0.1	916	0.1	1,954	0.4
	293,341	100.0	350,798	100.1	517,690	100.1	543,560	100.1	498,667	100.2
Unearned income and net unamortized deferred fees and costs	(130)	-	(297)	(0.1)	(582)	(0.1)	(807)	(0.1)	(1,111)	(0.2)
Loans, net of unearned income and unamortized fees and costs	$ 293,211	100.0	$ 350,501	100.0	$ 517,108	100.0	$ 542,753	100.0	$ 497,556	100.0

The following table presents the change in our loan portfolio (dollars are in thousands):

	December 31,		Increase (Decrease) 2011 – 2010		
	2011	2010	$	%	
Loans held for sale-mortgage banking	$ 68,622	$ 29,116	$ 39,506	135.7 %	(a)
Other loans held for sale	-	70,501	(70,501)	(100.0) %	(b)
Loans held for sale, net	68,622	99,617	(30,995)	(31.1) %	
Commercial and industrial	119,704	130,052	(10,348)	(8.0) %	(c)
Commercial real estate	115,704	153,919	(38,215)	(24.8) %	(c)
Consumer	23,038	25,841	(2,803)	(10.8) %	(c)
Land and land development	33,881	40,340	(6,459)	(16.0) %	(c)
Construction	1,014	646	368	57.0 %	
	293,341	350,798	(57,457)	(16.4) %	
Unearned income and net unamortized deferred fees and costs	(130)	(297)	167	(56.2) %	
Loans, net of unearned income and unamortized fees and costs	$ 293,211	$ 350,501	$ (57,290)	(16.3) %	

(a) Mortgage banking loans held for sale increased in 2011 as investors in mortgage loans became backlogged when the volume of refinanced loans increased.
(b) Other loans held for sale decreased when the divestiture discussed in Note 3 of our Consolidated Financial Statements was consummated.
(c) Loan balances have generally decreased due to repayments, charge-offs and our efforts to reduce credit exposure.

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 December 31 (dollars are in thousands):

2011	$	220,177
2010		259,939
2009		330,204
2008		315,469
2007		201,776

Concentrations of Credit

The following table summarizes the location of our borrowers as of December 31 (dollars are in thousands):

	2011		2010	
North Dakota	$ 157,622	54 %	$ 170,582	49 %
Minnesota	61,089	21	90,255	26
Arizona	28,382	9	35,930	10
Other	46,248	16	54,031	15
Total gross loans held for investment	$ 293,341	100 %	$ 350,798	100 %

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 (dollars are in thousands):

	2011		2010	
North Dakota	$ 147,275	50%	$ 162,364	46%
Arizona	32,902	11	47,333	14
Texas	24,010	8	26,761	7
California	23,092	8	31,106	9
Minnesota	20,718	7	27,448	8
Idaho	8,610	3	9,095	3
Colorado	7,736	3	6,333	2
Wisconsin	6,765	2	7,000	2
Other	22,233	8	33,358	9
Total gross loans held for investment	$ 293,341	100 %	$ 350,798	100 %

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

	2011 Total Loans and Leases Held for Investment	2010 Total Loans and Leases Held for Investment
North Dakota		
Commercial and industrial	$ 65,986	$ 80,536
Construction	2,533	1,029
Agricultural	13,043	13,673
Land and land development	10,579	10,682
Owner-occupied commercial real estate	25,526	24,941
Commercial real estate	12,100	12,567
Small business administration	2,333	3,116
Consumer	15,175	15,820
Subtotal	$ 147,275	$ 162,364
Arizona		
Commercial and industrial	$ 2,552	$ 606
Construction	-	-
Agricultural	-	-
Land and land development	5,832	8,621
Owner-occupied commercial real estate	550	814
Commercial real estate	14,070	26,797
Small business administration	7,085	7,446
Consumer	2,813	3,049
Subtotal	$ 32,902	$ 47,333
Minnesota		
Commercial and industrial	$ 1,316	$ 627
Construction	2,090	2,002
Agricultural	28	30
Land and land development	1,649	4,600
Owner-occupied commercial real estate	-	736
Commercial real estate	14,665	17,422
Small business administration	77	58
Consumer	893	1,973
Subtotal	$ 20,718	$ 27,448

Loan Maturities[1]

The following table sets forth the remaining maturities of loans in our portfolio as of December 31, 2011 (in thousands):

	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	$ 47,293	$ 28,571	$ 6,809	$ 20,923	$ 16,108	$ 119,704
Commercial real estate	29,174	40,894	29,144	7,961	8,531	115,704
Consumer	4,171	12,541	3,398	2,923	5	23,038
Land and land development	4,371	6,606	10,511	1,156	11,237	33,881
Construction	1,014	-	-	-	-	1,014
Total principal amount of loans	$ 86,023	$ 88,612	$ 49,862	$ 32,963	$ 35,881	$ 293,341

(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

Higher provisions for credit losses in recent periods reflect macroeconomic forces which impaired the ability of borrowers to repay debt which resulted in higher credit losses throughout the financial industry.

We provide for credit losses to maintain our allowance for credit losses at a level adequate to cover estimated probable losses inherent in the portfolio as of each balance sheet date. The provision for credit losses for the year ended December 31, 2011 was $1.625 million as compared to $5.750 million in 2010. The provision for credit losses decreased in 2011 as total loans and problem loans decreased significantly.

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 (dollars are in thousands):

Analysis of Allowance for Credit Losses

	For the Years ended December 31,				
	2011	2010	2009	2008	2007
Balance of allowance for credit losses, beginning of period	$ 14,765	$ 18,047	$ 8,751	$ 6,599	$ 3,370
Charge-offs:					
Commercial and industrial	(188)	(3,732)	(6,408)	(739)	(1,504)
Commercial real estate	(4,549)	(283)	(1,993)	(219)	-
Consumer	(1,049)	(533)	(394)	(459)	(623)
Land and land development	(731)	(3,238)	(9,081)	(4,529)	-
Construction	-	-	-	-	-
Total charge-offs	(6,517)	(7,786)	(17,876)	(5,946)	(2,127)
Recoveries:					
Commercial and industrial	70	19	12	84	1,501
Commercial real estate	506	-	-	-	-
Consumer	34	319	11	68	105
Land and land development	67	127	149	196	-
Construction	-	-	-	-	-
Total recoveries	677	465	172	348	1,606
Net charge-offs	(5,840)	(7,321)	(17,704)	(5,598)	(521)
Provision for credit losses charged to operations	1,625	5,750	27,000	7,750	3,750
	10,550	16,476	18,047	8,751	6,599
Transferred (to) from other loans held for sale	80	(1,711)	-	-	-
Balance of allowance for credit losses, end of period	$ 10,630	$ 14,765	$ 18,047	$ 8,751	$ 6,599
Ratio of net charge-offs to average total loans	(1.611)%	(1.387)%	(2.948)%	(0.507)%	(0.121)%
Ratio of net charge-offs to average loans and leases held for investment	(1.780)%	(1.530)%	(3.235)%	(0.534)%	(0.129)%
Average gross loans and leases held for investment	$ 328,091	$ 478,492	$ 547,336	$ 525,311	$ 402,615
Ratio of allowance for credit losses to loans and leases held for investment	3.63%	4.21%	3.49%	1.61%	1.33%
Ratio of allowance for credit losses to total nonperforming loans	172%	83%	50%	38%	122%
Allowance for credit losses to total loans	2.94%	3.84%	3.11%	1.50%	1.26%
Ratio of nonperforming loans to total assets	0.93%	2.39%	4.13%	2.66%	0.77%

The allowance for credit losses has been elevated in recent periods because of an increase in nonperforming assets and deteriorating economic conditions. In 2011, the level of nonperforming loans and total loans decreased significantly and according the allowance for credit losses decreased.

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 (dollars are in thousands).

Allocation of the Allowance for Loan Losses

	2011		2010		2009		2008		2007	
	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	$ 1,882	41%	$ 1,552	39%	$ 7,708	49%	$ 2,331	49%	$ 2,2963	44%
Commercial real estate	5,711	39%	10,035	43%	4,486	28%	1,281	25%	768	18%
Consumer	448	8%	1,182	7%	1,162	6%	844	7%	688	6%
Land and land development	2,583	12%	1,989	11%	4,689	17%	4,284	19%	2,826	32%
Construction	6	-	7	-	2	-	11	-	21	-
Total	$ 10,630	100%	$ 14,765	100%	$ 18,047	100%	$ 8,751	100%	$ 6,599	100%

The amount of the allowance for losses can vary depending on macroeconomic conditions and risk in the portfolio. The allocation of the allowance for losses can vary depending on relative volume of asset groups in the portfolio and risks therein.

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, 2011. 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, 2011	2010	2009	2008	2007
Nonperforming loans:					
Loans 90 days or more delinquent and still accruing interest	$ -	$ -	$ 1	$ 6	$ -
Non-accrual loans	6,169	17,862	35,889	22,909	5,399
Total nonperforming loans	6,169	17,862	35,890	22,915	5,399
Other real estate, net	10,145	12,706	7,253	10,189	-
Total nonperforming assets	$ 16,314	$ 30,568	$ 43,143	$ 33,104	$ 5,399
Allowance for credit losses	$ 10,630	$ 14,765	$ 18,047	$ 8,751	$ 6,599
Ratio of total nonperforming loans to total loans	1.70%	3.93%	6.19%	3.92%	1.03%
Ratio of total nonperforming loans to loans and leases held for investment	2.10%	5.10%	6.94%	4.22%	1.09%
Ratio of total nonperforming assets to total assets	2.45%	4.09%	4.97%	3.84%	0.77%
Ratio of nonperforming loans to total assets	0.93%	2.39%	4.13%	2.66%	0.77%
Ratio of allowance for credit losses to total nonperforming loans	172%	83%	50%	38%	122%

Nonperforming Loans

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

	2011	2010
Balance, beginning of period	$ 17,862	$ 35,890
Additions to nonperforming	6,312	7,385
Charge-offs	(3,895)	(3,991)
Reclassified back to performing	(3,616)	(5,208)
Principal payments received	(4,442)	(4,882)
Transferred to other real estate	(6,052)	(11,332)
Balance, end of period	$ 6,169	$ 17,862

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):

	2011	2010
Interest income that would have been recorded	$ 512	$ 1,601
Interest income recorded	60	427
Effect on interest income	$ 452	$ 1,174

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):

	Total	Accrual	Non-accrual
2011	$ 12,848	$ 7,270	$ 5,578
2010	34,264	18,482	15,782
2009	14,337	1,291	13,046
2008	2,379	-	2,379
2007	2,585	-	2,585

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 9 of our Consolidated Financial Statements for information on impaired loans.

Potential Problem Loans

The macroeconomic 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 there are loans risk rated "watch list" which are not impaired aggregating $5.0 million and $12.4 million at December 31, 2011 and 2010, respectively. Also, we estimate there are loans risk rated "substandard" which are not impaired aggregating $18.8 million and $29.7 million at December 31, 2011 and 2010, 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) 2011 – 2010		
	2011	2010	$	%	
Deposits:					
Non-interest-bearing	$ 116,864	$ 91,478	$ 25,386	28 %	(a)
Interest-bearing-					
Savings, interest checking and money market	269,075	243,332	25,743	11 %	(a)
Time deposits $100,000 and over	62,061	83,490	(21,429)	(26) %	(b)
Time deposits under $100,000	128,255	135,365	(7,110)	(5) %	(b)
Non-interest-bearing held for sale	-	34,610	(34,610)	100 %	(c)
Interest-bearing held for sale	-	72,836	(72,836)	100 %	(c)
Short-term borrowings	8,635	16,329	(7,694)	(47) %	(d)
FHLB advances	-	-	-	- %	
Other borrowings	-	-	-	- %	
Guaranteed preferred beneficial interests in Company's subordinated debentures	22,427	22,425	2	- %	
Accrued interest payable	3,609	2,561	1,048	41 %	(e)
Accrued expenses	6,244	4,704	1,540	33 %	(f)
Other liabilities	6,121	2,618	3,503	134 %	(g)
Total liabilities	623,291	709,748	(86,457)	(12) %	
Stockholders' equity	41,867	37,321	4,546	12 %	(h)
Total liabilities and stockholders' equity	$ 665,158	$ 747,069	$ (81,911)	(11) %	

(a) These deposits increased due to growth. Economic conditions in North Dakota, our primary market, have been relatively robust. 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 interest costs. Lower rates have resulted in lower balances.

(c) The balances decreased when we consummated the divestiture discussed in Note 3 of our Consolidated Financial Statements.

(d) Short term borrowings can vary depending on the cash needs of our customers. Short-term borrowings are primarily customer repurchase agreements. These balances can vary significantly depending on customer preferences.

(e) In 2010, we suspended payment of interest on our subordinated debt. See Note 2 of our Consolidated Financial Statements. Approximately $1.5 million of this increase relates to interest accrued and not paid in 2011.

(f) In 2010, we suspended payment on our dividends to preferred stockholders. See Note 2 of our Consolidated Financial Statements. Approximately $1.2 million of this increase relates to dividends accrued and not paid in 2011.

(g) Other liabilities increased by $3.5 million due to the increase in the fair value of commitments to sell mortgage loans. Also included in other liabilities is $800 thousand for contingent liabilities related to mortgage banking operations. See Note 20 of our Consolidated Financial Statements

(h) Managing capital has been a focus of management in recent periods. See Notes 2 and 29 of our Consolidated Financial Statements for regulatory capital ratios.

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):

	For the Years Ended December 31,								
	2011			2010			2009		
	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	$ 253,054	42.13%	0.37%	$ 282,880	40.55%	0.61%	$ 266,537	36.60%	0.89%
Savings deposits	12,655	2.11%	0.10%	11,156	1.60%	0.10%	11,685	1.61%	0.11%
Time deposits (CDs):									
CDs under $100,000	139,254	23.19%	2.02%	186,978	26.80%	2.90%	246,888	33.90%	3.09%
CDs $100,000 and over	71,432	11.89%	1.41%	99,141	14.21%	1.66%	125,372	17.22%	1.89%
Total time deposits	210,686	35.08%	1.81%	286,119	41.01%	2.47%	372,260	51.12%	2.68%
Total interest-bearing deposits	476,395	79.32%	1.00%	580,155	83.16%	1.52%	650,482	89.33%	1.90%
Non-interest-bearing demand deposits	124,208	20.68%	-	117,459	16.84%	-	77,736	10.67%	-
Total deposits	$ 600,603	100.00%	0.79%	$ 697,614	100.00%	1.26%	$ 728,218	100.00%	1.70%

In 2010 we were attempting to reduce deposits to improve capital ratios. Since the middle of 2011 we have returned to growing deposits.

Time deposits, in denominations of $100,000 and over, totaled $62.1 million at December 31, 2011 as compared to $83.5 million at December 31, 2010. The following table sets forth the amount and maturities of time deposits of $100,000 and over as of December 31, 2011 (in thousands):

Maturing in:	
3 months or less	$ 24,429
Over 3 months through 6 months	8,593
Over 6 months through 12 months	19,872
Over 12 months	9,167
	$ 62,061

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):

	2011	2010	2009
Short-term borrowings outstanding at period end	$ 8,635	$ 16,329	$ 10,190
Weighted average interest rate at period end	0.92%	0.48%	0.70%
Maximum month end balance during the period	$ 21,165	$ 16,329	$ 23,818
Average borrowings outstanding for the period	$ 15,583	$ 11,163	$ 17,953
Weighted average interest rate for the period	0.85%	0.65%	1.00%

Note 13 of our Consolidated Financial Statements summarizes the general terms of our short-term borrowings outstanding at December 31, 2011 and 2010.

FHLB advances totaled $0 at December 31, 2011 and 2010, respectively.

Notes 14 and 15 of our Consolidated Financial Statements summarize the general terms of our FHLB advances and other borrowings at December 31, 2011 and 2010.

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

	2011	2010	2009	2008	2007
Tier 1 leverage (Consolidated)	7.59%	6.17%	8.58%	9.01%	12.01%
Tier 1 risk-based capital (Consolidated)	13.71%	9.46%	12.32%	11.15%	12.58%
Total risk-based capital (Consolidated)	17.56%	12.89%	14.15%	12.95%	14.26%
Tangible common equity (Consolidated)	3.17%	2.24%	4.23%	6.21%	8.47%
Tier 1 leverage (BNC National Bank)	9.41%	7.53%	8.54%	9.34%	12.57%
Tier 1 risk-based capital (BNC National Bank)	16.95%	11.53%	12.25%	11.56%	13.18%
Total risk-based capital (BNC National Bank)	18.22%	12.80%	13.52%	12.81%	14.26%

See Note 2 of our Consolidated Financial Statements for a discussion of regulatory capital and the current operating environment. Improving capital ratios has been a focus of management in recent years.

In February 2012, we announced agreements to raise $17 million of common equity subject to regulatory approval. See Note 29 of our Consolidated Financial Statements.

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 20 and 21 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 20 of our Consolidated Financial Statements.

At December 31, 2011, 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	$ 8,635	$ -	$ -	$ 22,427	$ 31,062
Commitments to sell loans	66,533	-	-	-	66,533
Annual rental commitments under non-cancelable operating leases	474	356	336	1,677	2,843
Total	$ 75,642	$ 356	$ 336	$ 24,104	$ 100,438

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	$ 127,877	$ 10,842	$ 3,002	$ 45	$ 141,766
Standby and commercial letters of credit	1,930	583	-	-	2,513
Total	$ 129,807	$ 11,425	$ 3,002	$ 45	$ 144,279

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 meet our cash and collateral obligations when needed, 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 $50.9 million as of December 31, 2011. 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 Note 1 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, 2011 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, 2011 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, 2011, 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 2011 is shown below:

Net Interest Income Simulation

Movement in interest rates	-100bp	Unchanged	+100bp	+200bp	+300bp	+400bp
Projected 12-month net interest income	$ 18,059	$ 18,740	$ 19,648	$ 19,957	$ 19,969	$ 19,880
Dollar change from unchanged scenario	$ (681)	-	$ 908	$ 1,217	$ 1,229	$ 1,140
Percentage change from unchanged scenario	(3.63)%	-	4.85%	6.49%	6.56%	6.08%

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, 2011 (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.

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, 2011. Assets and liabilities are classified by the earliest possible repricing date or maturity, whichever occurs first (dollars are in thousands).

Interest Sensitivity Gap Analysis

	Estimated maturity or repricing at December 31, 2011				
	0–3 months	4–12 months	1–5 years	Over 5 years	Total
Interest-earning assets:					
Interest-bearing deposits with banks	$ 19,296	$ -	$ -	$ -	$ 19,296
Investment securities (a)	9,596	31,044	118,661	68,339	227,640
FRB and FHLB stock	2,750	-	-	-	2,750
Fed Funds Sold	-	-	-	-	-
Loans held for sale-mortgage banking, fixed rate	-	68,622	-	-	68,622
Loans held for sale-mortgage banking, floating rate	-	-	-	-	-
Other loans held for sale, fixed rate	-	-	-	-	-
Other loans held for sale, floating rate	-	-	-	-	-
Loans held for investment, fixed rate	42,664	41,940	72,371	17,511	174,486
Loans held for investment, floating rate	102,181	3,243	13,272	29	118,725
Total interest-earning assets	$ 176,487	$ 144,849	$ 204,304	$ 85,879	$ 611,519
Interest-bearing liabilities:					
Interest checking and money market accounts	$ 255,493	$ -	$ -	$ -	$ 255,493
Interest checking and money market accounts held for sale	-	-	-	-	-
Savings	13,582	-	-	-	13,582
Savings held for sale	-	-	-	-	-
Time deposits under $100,000	14,889	37,577	25,595	50,194	128,255
Time deposits $100,000 and over	24,429	28,465	9,019	148	62,061
Time deposits under $100,000 held for sale	-	-	-	-	-
Time deposits $100,000 and over held for sale	-	-	-	-	-
Short-term borrowings	8,635	-	-	-	8,635
FHLB advances	-	-	-	-	-
Other borrowings	-	-	-	-	-
Subordinated debentures	15,000	-	-	7,427	22,427
Total interest-bearing liabilities	$ 332,028	$ 66,042	$ 34,614	$ 57,769	$ 490,453
Interest rate gap	$ (155,541)	$ 78,807	$ 169,690	$ 28,110	$ 121,066
Cumulative interest rate gap at December 31, 2011	$ (155,541)	$ (76,734)	$ 92,956	$ 121,066	
Cumulative interest rate gap to total assets	(23.38)%	(11.54)%	13.98%	18.20%	

(a) Cash flows from securities are less than the fair value amount on the balance sheet due to the securities net unamortized premiums of $14.990 million.

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, 2011 and do not contemplate any actions we might undertake in response to changes in market interest rates.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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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, 2011 and 2010, 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, 2011 and 2010, 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 20, 2012

FINANCIAL INFORMATION

Financial Statements

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

ASSETS	2011	2010
CASH AND CASH EQUIVALENTS	$ 19,296	$ 112,847
INVESTMENT SECURITIES AVAILABLE FOR SALE	242,630	137,032
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	2,750	2,862
PARTICIPATING INTERESTS IN MORTGAGE LOANS	-	4,888
LOANS HELD FOR SALE-MORTGAGE BANKING	68,622	29,116
LOANS AND LEASES HELD FOR INVESTMENT	293,211	350,501
ALLOWANCE FOR CREDIT LOSSES	(10,630)	(14,765)
Net loans and leases held for investment	282,581	335,736
OTHER LOANS HELD FOR SALE, net	-	70,501
OTHER REAL ESTATE, net	10,145	12,706
PREMISES AND EQUIPMENT, net	16,035	16,684
ACCRUED INTEREST RECEIVABLE	2,411	2,138
OTHER ASSETS	20,688	19,790
PREMISES AND EQUIPMENT HELD FOR SALE, net	-	2,769
Total assets	$ 665,158	$ 747,069
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	$ 116,864	$ 91,478
Interest-bearing –		
Savings, interest checking and money market	269,075	243,332
Time deposits $100,000 and over	62,061	83,490
Time deposits under $100,000	128,255	135,365
	576,255	553,665
Non-interest-bearing held for sale	-	34,610
Interest-bearing held for sale	-	72,836
Total deposits	576,255	661,111
SHORT-TERM BORROWINGS	8,635	16,329
FEDERAL HOME LOAN BANK ADVANCES	-	-
OTHER BORROWINGS	-	-
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	22,427	22,425
ACCRUED INTEREST PAYABLE	3,609	2,561
ACCRUED EXPENSES	6,244	4,704
OTHER LIABILITIES	6,121	2,618
Total liabilities	623,291	709,748
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par value – Authorized 2,000,000 shares:		
Preferred Stock - 5% Series A 20,093 shares outstanding;	19,635	19,411
Preferred Stock - 9% Series B 1,005 shares outstanding;	1,052	1,075
Common stock, $.01 par value – Authorized 35,000,000 shares; 3,301,007 and 3,304,339 shares issued and outstanding	33	33
Capital surplus – common stock	27,217	27,036
Retained earnings (deficit)	(4,508)	(7,322)
Treasury stock (367,646 and 364,314 shares, respectively)	(5,076)	(5,069)
Accumulated other comprehensive income, net	3,514	2,157
Total stockholders' equity	41,867	37,321
Total liabilities and stockholders' equity	$ 665,158	$ 747,069

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)

	2011	2010
INTEREST INCOME:		
Interest and fees on loans	$ 17,651	$ 24,675
Interest and dividends on investments -		
Taxable	7,627	8,613
Tax-exempt	331	93
Dividends	140	129
Total interest income	25,749	33,510
INTEREST EXPENSE:		
Deposits	4,773	8,808
Short-term borrowings	132	73
Federal Home Loan Bank advances	-	113
Other borrowings	-	-
Subordinated debentures	1,367	1,244
Total interest expense	6,272	10,238
Net interest income	19,477	23,272
PROVISION FOR CREDIT LOSSES	1,625	5,750
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	17,852	17,522
NON-INTEREST INCOME:		
Bank charges and service fees	2,218	2,533
Wealth management revenues	1,282	2,133
Mortgage banking revenues	11,285	13,424
Gains on sales of loans, net	1,427	371
Gain on sales of securities, net	2,830	4,390
Other	1,195	1,122
Total non-interest income	20,237	23,973
NON-INTEREST EXPENSE:		
Salaries and employee benefits	14,972	16,080
Professional services	4,307	5,068
Other real estate costs	2,295	2,707
Data processing fees	2,673	2,697
Occupancy	2,028	2,885
Marketing and promotion	1,559	1,372
Regulatory costs	1,742	1,951
Depreciation and amortization	1,172	1,333
Office supplies and postage	590	603
Fraud loss on assets serviced by others	-	26,231
Other	2,521	2,561
Total non-interest expense	33,859	63,488
Income (loss) before income taxes	4,230	(21,993)
Income tax expense	22	72
Net income (loss)	$ 4,208	$ (22,065)
Preferred stock costs	(1,394)	(1,333)
Net income (loss) available to common shareholders	$ 2,814	$ (23,398)
Basic income (loss) per common share	$ 0.86	$ (7.13)
Diluted income (loss) per common share	$ 0.86	$ (7.13)

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)

	2011		2010	
NET INCOME (LOSS)		$ 4,208		$ (22,065)
Amortization of deferred gain in other comprehensive income	$ -		$ (40)	
Unrealized gain on securities available for sale	4,187		7,535	
Reclassification adjustment for gain included in net income	(2,830)		(4,390)	
Other comprehensive income, before tax	1,357		3,105	
Income tax expense related to items of other comprehensive income	-		-	
Other comprehensive income	1,357	1,357	3,105	3,105
TOTAL COMPREHENSIVE INCOME (LOSS)		$ 5,565		$ (18,960)

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

For the Years Ended December 31

(In thousands, except share data)

	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, 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)	-	-	-
Accrued 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
Net income	-	-	-	-	-	4,208	-	-	4,208
Other comprehensive income	-	-	-	-	-	-	-	1,357	1,357
Preferred stock amortization, net	-	201	-		-	(201)	-	-	-
Accrued dividend on preferred stock	-	-	-	-	-	(1,193)	-	-	(1,193)
Impact of share-based compensation	-	-	(3,332)	-	181	-	(7)	-	174
BALANCE, December 31, 2011	21,098	$ 20,687	3,301,007	$ 33	$ 27,217	$ (4,508)	$ (5,076)	$ 3,514	$ 41,867

See accompanying notes to consolidated financial statements

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

	2011	2010
OPERATING ACTIVITIES:		
Net income (loss)	$ 4,208	$ (22,065)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities -		
Provision for credit losses	1,625	5,750
Provision for other real estate losses	1,775	2,383
Depreciation and amortization	1,171	1,333
Net amortization of premiums and (discounts)	2,345	(269)
Share-based compensation	174	150
Change in interest receivable and other assets, net	(652)	5,928
Loss on disposals of bank premises and equipment, net	50	28
Fraud loss on assets serviced by others	-	26,231
(Gain) loss on sale of other real estate	(62)	126
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	(2,830)	(4,390)
Provision (benefit) for deferred income taxes	-	(48)
Change in other liabilities, net	4,381	986
Gains on sales of loans, net	(1,427)	(371)
Proceeds from sales of loans	14,831	4,264
Funding of originations of loans held for sale	(697,908)	(662,095)
Proceeds from sales of loans held for sale	660,480	656,844
Fair value adjustment for loans held for sale	(2,078)	265
Net cash provided by (used in) operating activities	(13,917)	14,750
INVESTING ACTIVITIES:		
Purchases of investment securities	(237,631)	(49,946)
Proceeds from sales of investment securities	100,439	84,450
Proceeds from maturities of investment securities	33,435	49,620
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(73)	(556)
Sales of Federal Reserve and Federal Home Loan Bank Stock	185	742
Net decrease in participating interests in mortgage loans	4,888	7,415
Cash used to finance divestiture	(10,966)	-
Net decrease in loans held for investment	36,887	71,848
Proceeds from sales of other real estate	6,900	3,370
Additions to bank premises and equipment	(596)	(604)
Proceeds from sales of bank premises and equipment	2,793	109
Net cash provided by (used in) investing activities	(63,739)	166,448

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)

	2011	2010
FINANCING ACTIVITIES:		
Net decrease in deposits held for sale	(30,792)	-
Net increase (decrease) in deposits	22,590	(94,852)
Net increase (decrease) in short-term borrowings	(7,693)	6,139
Repayments of Federal Home Loan Bank advances	(1,050)	(20,000)
Proceeds from Federal Home Loan Bank advances	1,050	5,000
Net cash used in financing activities	(15,895)	(103,713)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(93,551)	77,485
CASH AND CASH EQUIVALENTS, beginning of year	112,847	35,362
CASH AND CASH EQUIVALENTS, end of year	$ 19,296	$ 112,847
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 5,223	$ 10,855
Income taxes paid (received)	$ (391)	$ (6,166)
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to other real estate in settlement of loans	$ 6,052	$ 11,332
Loans sold in divestiture	$ 65,688	$ -
Deposits transferred in divestiture	$ 76,654	$ -
Transfer of 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). BNCCORP operates community banking and wealth management businesses in Arizona, Minnesota and North Dakota from 15 locations. The Bank also conducts mortgage banking from 12 locations in Arizona, Minnesota, Illinois, 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 problematic 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 loans which have been excluded from the specific reserve allocation.

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, 2011 and 2010.

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, 2011 and 2010, 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, 2011 or 2010.

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 have an ownership interest) 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 the Company'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 is also 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 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

The Company reviews long-lived 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.

There were no significant impairment charges in 2011 or 2010.

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.

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 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 24 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.

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, 2011, the Company had four stock-based employee compensation plans, which are described more fully in Note 27 to these consolidated financial statements.

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS

FASB ASU 2010-20, *Receivables (Topic 310), 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 interim and annual reporting periods ending on or after December 15, 2010 for public companies and on or after December 15, 2011 for non-public companies. Adoption of this ASU did not have a material impact on the Company's consolidated financial statements other than changes to disclosures. See Note 9 in the Company's notes to the consolidated financial statements.

FASB ASU No. 2011-02, *Receivables (Topic 310), A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring,* clarifies when the restructuring of a receivable should be considered a troubled debt restructuring (TDR). FASB issued the guidance in response to constituents' concerns that creditors were inconsistently applying the guidance for indentifying TDRs. The ASU provides additional guidance for determining whether the creditor has granted a concession and whether the debtor is experiencing financial difficulty. For nonpublic companies, this ASU is effective for annual periods ending after December 15, 2012, including interim periods within those annual periods. Adoption of this ASU will not have a material effect on the Company's consolidated financial statements, but generally will result in creditors identifying more TDRs.

In April 2011, the FASB issued ASU 2011-03, *Transfers and Servicing (Topic 860), Reconsideration of Effective Control for Repurchase Agreements. Topic 860, Transfers and Servicing,* prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements. That determination is based, in part, on whether the entity has maintained effective control over the transferred assets. The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. Other criteria applicable to the assessment of effective control are not changed by the amendments in this ASU. This ASU is effective for the first interim or annual period beginning on or after December 15, 2011 and should be applied prospectively to transactions or modification of existing transactions that occur on or after the effective date. The adoption of this ASU in the first quarter of 2012 is not anticipated to have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* The amendments in this ASU changes the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements in order to improve consistency in wording between U.S. GAAP and IFRS. This ASU is effective for interim or annual period beginning on or after December 15, 2011. The adoption of this ASU in the first quarter of 2012 is not anticipated to have a material impact on the Company's consolidated financial statements other than to change the disclosures relating to fair value measurements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income* (*Topic 220*), which requires companies to report total net income, each component of comprehensive income, and total comprehensive income on the face of the income statement, or as two consecutive statements. The components of comprehensive income will not be changed, nor does the ASU affect how earnings per share is calculated or reported. This ASU is effective for fiscal years, and interim periods beginning after December 15, 2011 for public companies, and for fiscal years and interim periods beginning after December 15, 2012 for non-public companies. The adoption of this ASU is not anticipated to have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011—5(Topic 220)*. This ASU defers the requirement to separately present items reclassified out of accumulated other comprehensive income on the face of the statement of net income. Instead, the proposed standard would require those adjustments be presented either within other comprehensive income of the comprehensive income statement or in the notes as U.S. GAAP currently requires. This proposal does not change the other requirements of the new standard, which become effective as originally planned. The effective date of the proposal is expected to be consistent with the newly issued standard on comprehensive income.

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		For Capital Adequacy Purposes		To be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2011						
Total Capital (to risk-weighted assets):						
Consolidated	$ 65,518	17.56 %	$ 29,850	≥8.0 %	$ N/A	N/A
BNC National Bank	67,853	18.22	29,799	≥8.0	37,249	10.0 %
Tier 1 Capital (to risk-weighted assets):						
Consolidated	51,138	13.71	14,925	≥4.0	N/A	N/A
BNC National Bank	63,124	16.95	14,899	≥4.0	22,349	6.0
Tier 1 Capital (to average assets):						
Consolidated	51,138	7.59	26,938	≥4.0	N/A	N/A
BNC National Bank	63,124	9.41	26,831	≥4.0	33,539	5.0
Tangible Capital (to total assets):						
Consolidated tangible equity	41,803	6.28	N/A	N/A	N/A	N/A
BNC National Bank	67,028	10.12	N/A	N/A	N/A	N/A
Tangible Common Capital (to total assets):						
Consolidated tangible common equity	21,116	3.17	N/A	N/A	N/A	N/A
2010						
Total Capital (to risk-weighted assets):						
Consolidated	$ 65,601	13.23 %	$ 39,669	≥8.0 %	$ N/A	N/A
BNC National Bank	3,380	12.8	39,612	≥8.0	49,515	10.0 %
Tier 1 Capital (to risk-weighted assets):						
Consolidated	46,885	9.46	19,835	≥4.0	N/A	N/A
BNC National Bank	57,106	11.53	19,806	≥4.0	29,709	6.0
Tier 1 Capital (to average assets):						
Consolidated	46,885	6.17	30,419	≥4.0	N/A	N/A
BNC National Bank	57,106	7.53	30,346	≥4.0	37,932	5.0
Tangible Capital (to total assets):						
Consolidated tangible equity	37,226	4.98	N/A	N/A	N/A	N/A
BNC National Bank	59,622	8.00	N/A	N/A	N/A	N/A
Tangible Common Capital (to total assets):						
Consolidated tangible common equity	16,740	2.24	N/A	N/A	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.

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. This agreement was lifted by the OCC in 2011.

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.

Accrued dividends on preferred stock and interest payable on debt have been accrued, but payment has been suspended pending regulatory approval. See Notes 16 and 17 for amounts for which payment is pending.

See also Footnote 29 for discussion of the subscription agreements announced in February of 2012.

NOTE 3. Divestiture

On March 11, 2011, the previously announced sale of certain assets and liabilities was consummated. The sale included the Company's Scottsdale, Arizona branch premises; certain Arizona-based deposit accounts and loans; and certain deposit accounts and loans of The Company's offices in Minneapolis and Golden Valley, Minnesota. The Company continues to offer a full range of banking services in the Arizona and Minnesota markets following the sale.

The sale did not affect our North Dakota, wealth management, or mortgage banking operations.

As of December 31, 2010, the assets and liabilities included in the divestiture were 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 was $72.2 million and the allowance for losses allocated to these loans at year end was $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 was no significant gain or loss incurred as a result of the divestiture.

NOTE 4. Fraud Loss on Assets Serviced by Others

As previously reported, the Company discovered fraudulent activity in April of 2010 by an external company that was servicing residential mortgage loans for the Company. Subsequently, the Company and its advisors have been diligently addressing this matter. 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 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, in the fourth quarter of 2010, 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 counter sued the insurance carriers for failure to honor the policies and for acting in bad faith. We intend to vigorously pursue our claims to recover amounts due under the insurance policies and for losses incurred as a result of the carriers acting 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, 2011 and 2010.

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, 2011 or 2010. The carrying amount of available-for-sale securities and their approximate fair values were as follows as of December 31 (in thousands):

	2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	$ 57,912	$ 1,388	$ -	$ 59,300
U.S. government agency mortgage-backed securities issued by FNMA	6,004	169	(2)	6,171
Collateralized mortgage obligations guaranteed by GNMA/VA	127,551	837	(841)	127,547
Collateralized mortgage obligations issued by FNMA or FHLMC	13,169	169	(17)	13,321
Other collateralized mortgage obligations	11,179	313	(5)	11,487
State and municipal bonds	22,670	2,134	-	24,804
	$ 238,485	$ 5,010	$ (865)	$ 242,630

	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/VA	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

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at December 31, 2011, 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	2,213	2,541
Due after ten years	236,272	240,089
Total	$ 238,485	$ 242,630

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

Securities carried at approximately $73.7 million and $74.0 million at December 31, 2011 and 2010, 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):

	2011	2010
Sales proceeds	$ 100,439	$ 84,450
Gross realized gains	3,348	4,791
Gross realized losses	(518)	(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):

	2011								
	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	55	(2)	1	55	(2)
Collateralized mortgage obligations guaranteed by GNMA/VA	16	73,619	(841)	-	-	-	16	73,619	(841)
Collateralized mortgage obligations issued by FNMA or FHLMC	1	4,679	(17)	-	-	-	1	4,679	(17)
Other collateralized mortgage obligations	1	233	(5)	-	-	-	1	233	(5)
State and municipal bonds	-	-	-	-	-	-	-	-	-
Total temporarily impaired securities	18	$ 78,531	$ (863)	1	$ 55	$ (2)	19	$ 78,586	$ (865)

	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/VA	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)

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, the level of credit support provided by subordinate tranches, and the collateral underlying the security.

There were no securities that management concluded were other-than-temporarily impaired in either 2011 or 2010.

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):

	2011	2010
Federal Reserve Bank Stock, at cost	$ 1,806	$ 1,772
Federal Home Loan Bank of Des Moines Stock, at cost	944	1,090
Total	$ 2,750	$ 2,862

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

NOTE 8. Loans and Leases

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

	2011	2010
Loans held for sale-mortgage banking	$ 68,622	$ 29,116
Other loans held for sale	-	70,501
Loans held for sale, net	$ 68,622	$ 99,617
Commercial and industrial	119,704	130,052
Commercial real estate	115,704	153,919
Consumer	23,038	25,841
Land and land development	33,881	40,340
Construction	1,014	646
	293,341	350,798
Unearned income and net unamortized deferred fees and	(130)	(297)
Loans, net of unearned income and unamortized fees and costs	293,211	350,501
Allowance for credit losses	(10,630)	(14,765)
Net loans and leases held for investment	$ 282,581	$ 335,736

Loans to Related Parties

Note 22 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, 2011, the future minimum annual lease payments for direct finance lease obligations were as follows (in thousands):

2012	$ 24
2013	-
2014	-
2015	-
2016	-
Thereafter	-
Total future minimum lease payments	24
Unguaranteed residual values	200
Total all payments	224
Unearned income	(2)
Net outstanding principal amount	$ 222

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):

	2011	2010
Commercial and industrial	$ 23,861	$ 115,336
Commercial real estate	45,246	3,731
Consumer	14,822	23,025
	$ 83,929	$ 142,092

NOTE 9. Allowance for Credit Losses

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

	2011					
	Commercial and industrial	Commercial real estate	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 1,552	$ 10,035	$ 1,182	$ 1,989	$ 7	$ 14,765
Provision for credit losses	368	(281)	281	1,258	(1)	1,625
Loans charged off	(188)	(4,549)	(1,049)	(731)	-	(6,517)
Loan recoveries	70	506	34	67	-	677
	1,802	5,711	448	2,583	6	10,550
Transferred from other loans held for sale	80	-	-	-	-	80
Balance end of period	$ 1,882	$ 5,711	$ 448	$ 2,583	$ 6	$ 10,630

	2010					
	Commercial and industrial	Commercial real estate	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 7,708	$ 4,486	$ 1,162	$ 4,689	$ 2	$ 18,047
Provision for credit losses	(732)	5,832	234	411	5	5,750
Loans charged off	(3,732)	(283)	(533)	(3,238)	-	(7,786)
Loan recoveries	19	-	319	127	-	465
	3,263	10,035	1,182	1,989	7	16,476
Transferred to other loans held for sale	(1,711)	-	-	-	-	(1,711)
Balance end of period	$ 1,552	$ 10,035	$ 1,182	$ 1,989	$ 7	$ 14,765

Performing and non-accrual loans

The Bank's key credit quality indicator is the loan's performance status, defined as accrual or non-accrual. Performing loans are considered to have a lower risk of loss and are on accrual status. 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. Delinquent balances are determined based on the contractual terms of the loan adjusted for charge-offs and payments applied to principal.

The following table sets forth information regarding the Bank's performing and non-accrual loans (in thousands):

	2011					
	Current	31-89 Days Past Due	90 Days or More Past Due	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	$ 67,437	$ 1	$ -	$ 67,438	$ 247	$ 67,685
Agriculture	13,060	64	-	13,124	-	13,124
Owner-occupied commercial real estate	38,895	-	-	38,895	-	38,895
Commercial real estate	110,597	-	-	110,597	5,107	115,704
Consumer:						
Automobile	3,082	-	-	3,082	-	3,082
Home equity	3,347	-	-	3,347	-	3,347
1st mortgage	9,257	121	-	9,378	815	10,193
Other	6,408	8	-	6,416	-	6,416
Land and land development	33,881	-	-	33,881	-	33,881
Construction	1,014	-	-	1,014	-	1,014
Total loans held for investment	286,978	194	-	287,172	6,169	293,341
Loans held for sale	68,622	-	-	68,622	-	68,622
Total gross loans	$ 355,600	$ 194	$ -	$ 355,794	$ 6,169	$ 361,963

	2010					
	Current	31-89 Days Past Due	90 Days or More Past Due and Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	$ 77,217	$ 19	$ -	$ 77,236	$ 388	$ 77,624
Agriculture	15,114	-	-	15,114	-	15,114
Owner-occupied commercial real estate	37,314	-	-	37,314	-	37,314
Commercial real estate	140,487		-	140,487	13,432	153,919
Consumer:						
Automobile	1,631	-	-	1,631	-	1,631
Home equity	3,278	-	-	3,278	-	3,278
1st mortgage	11,894	-	-	11,894	1,914	13,808
Other	7,105	19	-	7,124	-	7,124
Land and land development	38,461	-	-	38,461	1,879	40,340
Construction	646	-	-	646	-	646
Total loans held for investment	333,147	38	-	333,185	17,613	350,798
Loans held for sale	98,162	1,206	-	99,368	249	99,617
Total gross loans	$ 431,309	$ 1,244	$ -	$ 432,553	$ 17,862	$ 450,415

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):

	2011	2010
Interest income that would have been recorded	$ 512	$ 1,601
Interest income recorded	60	427
Effect on interest income	$ 452	$ 1,174

Impaired loans

Impaired loans include loans the Bank will not be able to collect all amounts due in accordance with the terms of the loan agreement. Impaired loans include non-accruing and loans that have been modified in a trouble debt restructuring. All loans are individually reviewed for impairment.

The following table summarizes impaired loans and related allowances for the years ended December 31, 2011 and 2010 (in thousands):

	2011				
	Unpaid Principal	Recorded Investment	Related Allowance	Average Recorded Balance	Interest Income Recognized
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	$ 232	$ 220	$ 220	$ 227	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	7,206	5,107	777	5,238	4
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	$ 7,438	$ 5,327	$ 997	$ 5,465	$ 4
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	-	-	-	-	-
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	$ -	$ -	$ -	$ -	$ -
TOTAL IMPAIRED LOANS	$ 7,438	$ 5,327	$ 997	$ 5,465	$ 4

	2010				
	Unpaid Principal	Recorded Investment	Related Allowance	Average Recorded Balance	Interest Income Recognized
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	$ 503	$ 345	$ 35	$ 360	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	16,751	13,432	1,574	16,534	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	1,914	1,914	570	570	-
Other	-	-	-	-	-
Land and land development	2,716	1,879	282	2,209	-
Construction	-	-	-	-	-
Loans held for sale	249	249	249	249	-
Total impaired loans with an allowance recorded	$ 22,133	$ 17,819	$ 2,710	$ 19,922	$ -
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	$ 163	$ 43	$ -	$ 42	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
Consumer:	-				
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	$ 163	$ 43	$ -	$ 42	$ -
TOTAL IMPAIRED LOANS	$ 22,296	$ 17,862	$ 2,710	$ 19,964	$ -

Troubled Debt Restructuring (TDRs)

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

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

	2011			
	Accrual	Non-accrual	Total	Reserve
Commercial and industrial:				
Business loans	$ -	$ -	$ -	$ -
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	3,904	4,763	8,667	554
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	815	815	122
Other	-	-	-	-
Land and land development	3,366	-	3,366	67
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	$ 7,270	$ 5,578	$ 12,848	$ 743

	2010			
	Accrual	Non-accrual	Total	Reserve
Commercial and industrial:				
Business loans	$ -	$ 345	$ 345	$ 35
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	12,997	11,644	24,641	4,202
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	1,914	1,914	570
Other	-	-	-	-
Land and land development	5,485	1,879	7,364	594
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	$ 18,482	$ 15,782	$ 34,264	$ 5,401

The amount of additional funds committed to borrowers who are in TDR status was $232,000 at December 31, 2011 and $0 at December 31, 2010.

TDRs are evaluated separately in the Bank's allowance methodology based on the expected cash flows or collateral values for loans in this status.

The Bank had $0 of restructured loans that were modified in a troubled-debt restructuring within the previous twelve months for which there was a payment default.

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):

	2011		2010	
Balance, beginning of year	$	12,706	$	7,253
Transfers from nonperforming loans		6,052		11,332
Real estate sold		(6,900)		(3,370)
Net gains (losses) on sale of assets		62		(126)
Provision		(1,775)		(2,383)
Balance, end of year	$	10,145	$	12,706

The following is a summary of ORE as of December 31 (in thousands):

	2011		2010	
Other real estate	$	15,530	$	17,116
Valuation allowance		(5,385)		(4,410)
Other real estate, net	$	10,145	$	12,706

NOTE 11. Premises and Equipment, net

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

	2011		2010	
Land and improvements	$	5,220	$	5,220
Buildings and improvements		11,593		11,393
Leasehold improvements		536		1,611
Furniture, fixtures and equipment		8,799		9,133
Total cost		26,148		27,357
Less accumulated depreciation and amortization		(10,113)		(10,673)
Net premises, leasehold improvements and equipment	$	16,035	$	16,684

Depreciation and amortization expense totaled approximately $1.2 million and $1.3 million for the years ended December 31, 2011 and 2010, respectively.

NOTE 12. Deposits

The scheduled maturities of time deposits as of December 31, 2011 are as follows (in thousands):

2012	$	105,360
2013		19,532
2014		3,648
2015		471
2016		10,963
Thereafter		50,342
	$	190,316

At December 31, 2011 and 2010, the Bank had $59.8 million and $67.0 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):

	2011	2010
Savings	$ 13	$ 11
Interest checking	352	659
Money market	588	1,070
Time deposits	3,820	7,068
	$ 4,773	$ 8,808

Deposits Received from Related Parties

Note 22 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):

	2011	2010
Federal reserve borrowings-U. S. Treasury tax and loan retainer	$ -	$ 2,000
Repurchase agreements with customers, renewable daily, interest payable monthly, rates ranging from 0.40% to 3.25% in 2011, and 0.25% to 0.90% in 2010, secured by government agency collateralized mortgage obligations	8,635	14,329
	$ 8,635	$ 16,329

The weighted average interest rate on short-term borrowings outstanding as of December 31, 2011 and 2010 was 0.92% and 0.48%, 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, 2011, $8.6 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.92% were collateralized by government agency collateralized mortgage obligations having a market value of $21.0 million and unamortized principal balances of $19.5 million. At December 31, 2010, $14.3 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.56% were collateralized by government agency collateralized mortgage obligations having a market value of $23.7 million and unamortized principal balances of $22.5 million.

NOTE 14. Federal Home Loan Bank Advances

As of December 31, 2011, the Bank had $0 of FHLB advances outstanding. At December 31, 2011, the Bank has mortgage loans with unamortized principal balances of approximately $71.7 million and securities with unamortized principal balances of approximately $11.5 million which were pledged as collateral to the FHLB. The Bank has the ability to draw advances up to approximately $50.9 million based upon the mortgage loans and securities that are currently pledged, subject to a requirement to purchase additional FHLB stock.

NOTE 15. Other Borrowings

As of December 31, 2011, 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, 2011 and 2010. 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 $16.9 million as of December 31, 2011 resulting in unused borrowing capacity of $13.5 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, 2011 was 1.77% and the interest rate reset on January 3, 2012 to 1.98%. 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, 2011. At December 31, 2011 accrued interest owed on the subordinated debentures aggregated $3.2 million which is included in interest payable. At December 31, 2010 accrued interest owed on the subordinated debentures aggregated $1.8 million which is included in interest payable.

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, 2011 and 2010. 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, 2011 and 2010.

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. As of December 31, 2011, the Treasury department has not appointed a representative to the Board, but has periodically elected to observe Board meetings in a non-voting capacity. At December 31, 2011, the Company has recorded the accrued dividends aggregating $2.5 million which is included in other liabilities in the consolidated financial statements. At December 31, 2010, the Company has recorded the accrued dividends aggregating $1.3 million which is included in other liabilities in the consolidated financial statements.

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, 2011, 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.

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 plan was amended in 2011 such that it now expires on May 30, 2021.

NOTE 18. 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):

	2011			
	Total	Level 1	Level 2	Level 3
ASSETS				
Securities available for sale	$ 242,630	$ -	$ 242,630	$ -
Loans held for sale-mortgage banking	68,622	-	68,622	-
Commitments to originate mortgage loans	2,315	-	2,315	-
Total assets at fair value	$ 313,567	$ -	$ 313,567	$ -
LIABILITIES				
Commitments to sell mortgage loans	$ 4,376	$ -	$ 4,376	$ -
Total liabilities at fair value	$ 4,376	$ -	$ 4,376	$ -

	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	$ -

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, 2011 and 2010. 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):

	2011				
	Total	Level 1	Level 2	Level 3	Total gains/ (losses)
Impaired loans[1]	$ 4,330	$ -	$ 4,330	$ -	$ (65)
Other real estate[2]	10,145	-	10,145	-	(1,713)
Total	$ 14,475	$ -	$ 14,475	$ -	$ (1,778)

	2010				
	Total	Level 1	Level 2	Level 3	Total gains/ (losses)
Impaired loans[1]	$ 15,152	$ -	$ 15,152	$ -	$ (2,260)
Other real estate[2]	12,706	-	12,706	-	(2,509)
Total	$ 27,858	$ -	$ 27,858	$ -	$ (4,769)

(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 19. Fair Value of Financial Instruments

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

	2011		2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Cash and cash equivalents	$ 19,296	$ 19,296	$ 112,847	$ 112,847
Investment securities available for sale	242,630	242,630	137,032	137,032
Federal Reserve Bank and Federal Home Loan Bank stock	2,750	2,750	2,862	2,862
Loans held for sale-mortgage banking	68,622	68,622	29,116	29,116
Participating interests in mortgage loans	-	-	4,888	4,888
Loans and leases held for investment, net	282,581	282,787	335,736	334,413
Other loans held for sale, net	-	-	70,501	70,501
Accrued interest receivable	2,411	2,411	2,138	2,138
	$ 618,290	$ 618,496	$ 695,120	$ 693,797
Liabilities and Stockholders' Equity:				
Deposits, noninterest-bearing	$ 116,864	$ 116,864	$ 91,478	$ 91,478
Deposits, interest-bearing	459,391	460,506	462,187	461,944
Deposits, noninterest-bearing held for sale	-	-	34,610	34,610
Deposits, interest-bearing held for sale	-	-	72,836	72,836
Borrowings and advances	8,635	8,635	16,329	16,329
Accrued interest payable	3,609	3,609	852	852
Accrued expenses	6,244	6,244	4,704	4,704
Guaranteed preferred beneficial interests in Company's subordinated debentures	22,427	12,731	24,134	11,356
	$ 617,170	$ 608,589	$ 707,130	$ 694,109
Financial instruments with off-balance-sheet risk:				
Commitments to extend credit		$ 40		$ 31
Standby and commercial letters		25		37
Mortgage banking commitments to fund loans		2,315		488
Mortgage banking commitments to sell loans		(4,376)		(470)

NOTE 20. 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, 2011, based on current information, no losses were anticipated as a result of these commitments.

	2011	2010
Balance, beginning of period	$ 501	$ 326
Provision	404	274
Write offs	(105)	(99)
Balance, end of period	$ 800	$ 501

NOTE 21. 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, 2011 and 2010, the Bank had outstanding $1.7 million and $2.3 million of performance standby letters of credit and $6.1 million and $7.2 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 22. 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 been made 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 $1.3 million and $674,000 at December 31, 2011 and 2010, respectively. Originations in 2011 and 2010 totaled $709,000 and $375,000, respectively. Loan paydowns in 2011 and 2010 were $124,000 and $1.5 million, respectively. The total amount of deposits received from these parties was $1.9 million and $2.0 million at December 31, 2011 and 2010, 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, 2011, BNCCORP and its affiliates were in compliance with these requirements.

NOTE 23. Income Taxes

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

	2011	2010
Current:		
Federal	$ 17	$ -
State	5	120
	22	120
Deferred:		
Federal	997	(7,222)
State	386	(1,658)
Valuation allowance	(1,383)	8,832
	-	(48)
Total	$ 22	$ 72

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):

	2011	2010
Tax (benefit) at 34% statutory rate	$ 1,438	$ (7,478)
State taxes (net of Federal benefit)	388	(1,110)
Tax-exempt interest	(116)	(38)
Cash surrender values of bank-owned life insurance	(179)	(177)
Other, net	(126)	43
	1,405	(8,760)
Deferred tax valuation allowance	(1,383)	8,832
	$ 22	$ 72

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):

	2011	2010
Deferred tax asset:		
Loans, primarily due to credit losses	$ 4,607	$ 6,673
Fraud loss on assets serviced by others	5,709	5,709
Acquired intangibles	236	257
Net operating loss carryforwards	3,456	2,659
Alternative minimum tax credits	612	612
Other real estate owned	2,602	2,672
Other	414	335
Deferred tax asset	17,636	18,917
Deferred tax liability:		
Unrealized gain on securities available for sale	1,581	1,066
Discount accretion on securities	1,571	1,603
Leases	84	173
Premises and equipment	739	604
Other	347	259
Deferred tax liability	4,322	3,705
	13,314	15,212
Valuation allowance	(13,266)	(15,164)
Net deferred tax asset	$ 48	$ 48

A valuation allowance is required because cumulative losses in the 36 month periods ended December 31, 2011 and 2010 exceeded cumulative earnings. The remaining net deferred tax asset of $48,000 relates to miscellaneous recoverable amounts.

The Company is able to carry forward federal tax net operating losses aggregating $6.099 million as of December 31, 2011. The carry forward period is 18 to 20 years. The Company is able to carry forward state tax net operating losses aggregating $19.7 million as of December 31, 2011. The state net operating losses expire between 2012 and 2032.

At December 31, 2011, the Company had an unrecognized tax benefit of $115,000. 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 $20,000 of interest accrued at December 31, 2011 and no penalties. Interest included in tax expense for 2010 is approximately $8,000.

It is reasonably possible the unrecognized tax benefit discussed above may be reduced by $54,000 within the next twelve months. This amount includes $12,000 of interest and no penalties.

The Company files consolidated federal and unitary state income tax returns where allowed. Tax years ended December 31, 2007 through 2010 remain open to federal examination. During 2010, the Internal Revenue Service opened an examination of the Company's 2009 federal income tax return. The audit was completed in 2011. Tax years ended December 31, 2007 through 2010 remain open to state examinations.

NOTE 24. Earnings (Loss) Per Share

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

Net income (loss) per share was calculated as follows:	2011	2010
Denominator for basic earnings (loss) per share:		
Average common shares outstanding	3,282,182	3,281,719
Dilutive common stock options	-	-
Denominator for diluted earnings (loss) per share	3,282,182	3,281,719
Numerator (in thousands):		
Net income (loss)	$ 4,208	$ (22,065)
Preferred stock costs	(1,394)	(1,333)
Net income (loss) available to common shareholders	$ 2,814	$ (23,398)
Basic earnings (loss) per common share	$ 0.86	$ (7.13)
Diluted earnings (loss) per common share	$ 0.86	$ (7.13)

At December 31, 2011 and 2010, options totaling 236,500 and 269,700, 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 $7.00.

NOTE 25. 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 2011 and 2010, 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 $378,000 and $426,000 for 2011, and 2010, 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, 2011, the assets in the plan totaled $15.4 million and included $296,000 (100,775 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 26. Commitments and Contingencies

Employment Agreements and Noncompete Covenants
The Company has entered into an employment agreement with its President and Chief Executive Officer. The Company has also entered into an employment agreement with its Chief Credit Officer. 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, 2011 and 2010 was $970,000 million and $1.729 million, respectively, for facilities, and $42,000 and $40,000, respectively, for equipment and other items. At December 31, 2011, the total minimum annual base lease payments for operating leases were as follows (in thousands):

2012	$	474
2013		190
2014		166
2015		171
2016		165
Thereafter		1,677

NOTE 27. 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. 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 in plan, total shares available, and maximum restricted shares available as of December 31, 2011 are as follows:

	1995 Stock Incentive Plan	2002 Stock Incentive Plan	2006 Stock Incentive Plan	2010 Stock Incentive Plan	Total
Total Shares in Plan	250,000	125,000	200,000	250,000	825,000
Total Shares Available	79,451	-	15,850	250,000	344,101
Maximum Restricted Shares Available	79,451	-	15,850	35,000	129,101

The Company recognized share-based compensation expense of $42,000 and $38,000 for the years ended December 31, 2011 and 2010, respectively, related to restricted stock.

The tax benefits associated with share-based compensation would have been approximately $10,000 and $2,000 for the years ended December 31, 2011 and 2010, respectively if the Company had not been in a full valuation allowance.

At December 31, 2011, the Company had $35,000 of unamortized restricted stock compensation. At December 31, 2010, the Company had $77,000 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:

	2011		2010	
	Number Restricted Stock Shares	**Weighted Average Grant Date Fair Value**	**Number Restricted Stock Shares**	**Weighted Average Grant Date Fair Value**
Nonvested, beginning of year	20,500	$ 4.42	8,500	$ 12.04
Granted	-	-	15,000	1.61
Vested	(11,400)	4.39	(3,000)	11.93
Forfeited	-	-	-	-
Nonvested, end of year	9,100	4.47	20,500	4.42

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 $140,000 and $111,000 for the years ended December 31, 2011 and 2010, respectively, related to share options. At December 31, 2011, the Company had $29,000 of unamortized compensation cost related to non-vested stock options granted.

The Company 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, 2011:

	Stock Options Outstanding	**Stock Options Currently Exercisable**	**Stock Options Vested and Expected to Vest**
Number	236,500	122,500	236,500
Weighted-average exercise price	$3.14	$3.28	$3.14
Weighted-average remaining contractual term	7.99	7.75	7.99

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

	2011		2010	
	Options to Purchase Shares	Weighted Average Exercise Price	Options to Purchase Shares	Weighted Average Exercise Price
Outstanding, beginning of year	269,700	3.49	41,700	$ 6.20
Granted	-	-	240,000	3.00
Exercised	-	-	-	-
Forfeited	(33,200)	5.99	(12,000)	3.00
Outstanding, end of year	236,500	3.14	269,700	$ 3.49
Exercisable, end of year	122,500	3.28	41,700	$ 6.20
Weighted average fair value of				
Granted	$ -		$ 1.23	
Exercised	$ -		$ -	
Forfeited	$ 2.82		$ 1.23	

Following is a summary of the status of options outstanding at December 31, 2011:

	Outstanding Options			Exercisable Options	
	Number	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Options with exercise prices of:					
$3.00	228,000	8.3 years	$ 3.00	114,000	$ 3.00
$7.00	8,500	1 year	$ 7.00	8,500	$ 7.00
	236,500			122,500	

NOTE 28. Condensed Financial Information-Parent Company Only

Condensed financial information of BNCCORP, INC. 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)

	2011	2010
Assets:		
Cash and cash equivalents	$ 3,242	$ 2,377
Investment securities available for sale	-	-
Investment in subsidiaries	63,825	57,807
Receivable from subsidiaries	155	883
Other	241	473
Total assets	$ 67,463	$ 61,540
Liabilities and stockholders' equity:		
Subordinated debentures	$ 23,123	$ 23,120
Payable to subsidiaries	42	43
Accrued expenses and other liabilities	6,396	3,664
Total liabilities	29,561	26,827
Preferred stock, $.01 par value. Authorized 2,000,000 shares:		
Preferred Stock - 5% Series A 20,093 shares issued and outstanding;	19,635	19,411
Preferred Stock - 9% Series B 1,005 shares issued and outstanding;	1,052	1,075
Common stock, $.01 par value – Authorized 35,000,000 shares 3,301,007 and 3,304,339 shares issued and outstanding	33	33
Capital surplus – common stock	27,217	27,036
Retained earnings	(4,508)	(7,322)
Treasury stock (367,646 and 364,314 shares, respectively)	(5,076)	(5,069)
Accumulated other comprehensive loss net of income taxes	(451)	(451)
Total stockholders' equity	37,902	34,713
Total liabilities and stockholders' equity	$ 67,463	$ 61,540

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

	2011	2010
Income:		
Management fee income	$ 1,661	$ 1,596
Interest	6	27
Gain on sale of securities	-	2,150
Other	38	38
Total income	1,705	3,811
Expenses:		
Interest	1,402	1,279
Salaries and benefits	748	708
Legal and other professional	517	542
Depreciation and amortization	1	1
Other	831	677
Total expenses	3,499	3,207
Income (loss) before income tax benefit and equity in income of subsidiaries	(1,794)	604
Income tax benefit	(16)	(582)
Income (loss) before equity in income of subsidiaries	(1,810)	22
Equity in earnings (loss) of subsidiaries	6,018	(22,087)
Net income (loss)	$ 4,208	$ (22,065)

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

	2011	2010
Operating activities:		
Net income (loss)	$ 4,208	$ (22,065)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities -		
Equity in undistributed loss of subsidiaries	(6,018)	22,087
Depreciation and amortization	3	3
Share based compensation	181	150
Change in prepaid expenses and other receivables	953	6,206
Net realized gain on sale of investment securities	-	(2,150)
Change in accrued expenses and other liabilities	1,538	(6,343)
Net cash provided by (used in) operating activities	865	(2,112)
Investing activities:		
Increase in investment in subsidiaries	-	(2,000)
Proceeds from sale of investment securities	-	2,150
Net cash provided by investing activities	-	150
Financing activities:		
Proceeds from issuance of preferred stock	-	-
Payment of preferred stock dividends	-	-
Net cash provided by (used in) financing activities	-	-
Net increase (decrease) in cash and cash equivalents	865	(1,962)
Cash and cash equivalents, beginning of year	2,377	4,339
Cash and cash equivalents, end of year	$ 3,242	$ 2,377
Supplemental cash flow information:		
Interest paid	$ -	$ -
Income taxes received	$ (391)	$ (5,972)

NOTE 29. Subsequent Events

On February 16, 2012, the Company announced that it has received subscription agreements executed by prospective investors pursuant to which the Company expects to receive aggregate gross proceeds of up to $17,020,000 from the private placement of newly issued shares of the Company's common stock. The closing of the offering is subject to obtaining all required regulatory approvals and the satisfaction of other customary closing conditions and is not anticipated to close later until the second or third quarter of 2012.

Upon closing of the offering, the Company expects to issue up to 9,200,000 shares of common stock at a price of $1.85 per share. The Company intends to use the net proceeds from the offering for general corporate purposes, which we anticipate will include, subject to obtaining required regulatory approvals and the availability of additional borrowings, the repayment of accrued and unpaid dividends and interest on our outstanding preferred stock and trust preferred securities and the redemption of all of our outstanding preferred stock.

The Company has evaluated subsequent events from the balance sheet date through March 20, 2012, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.

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CORPORATE DATA

Investor Relations

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

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

General Inquiries:

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322 East Main Avenue
Bismarck, North Dakota 58501
Telephone (701) 250-3040
Facsimile (701) 222-3653

E-mail Inquiries:
corp@bncbank.com

Annual Meeting

The 2012 annual meeting of stockholders will be held on Wednesday, June 20, 2012 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 67 record holders of the Company's common stock at March 20, 2012.

COMMON STOCK PRICES

For the Years Ended December 31,

	2011(1)		2010(1)	
	High	Low	High	Low
First Quarter	$3.15	$1.55	$4.00	$1.80
Second Quarter	$3.09	$2.15	$3.19	$1.80
Third Quarter	$2.50	$1.75	$2.25	$1.40
Fourth Quarter	$3.15	$1.41	$2.00	$1.41

(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 (Inactive)
President and Chief Executive Officer

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

Gaylen Ghylin, CPA (Inactive)
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
BNC National Bank

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

SUBSIDIARIES

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Glendale, AZ 85308

Bank Branches:
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322 East Main Avenue
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

Touchmark 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
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Stanley, ND 58784

Watford City
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Watford City, ND 58854

Minneapolis
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Minneapolis, MN 55402

Golden Valley
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Golden Valley, MN 55422

Perimeter
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Scottsdale, AZ 85255

Mortgage Banking Branches:
Scottsdale
17550 North Perimeter Drive
Scottsdale, AZ 85255

Glendale
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Glendale, AZ 85383

Golden Valley
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Golden Valley, MN 55422

Minnetonka
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Minnetonka, MN 55343

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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

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Topeka, KS 66614

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Independence
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Independence, MO 64055

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Lincoln, NE 68516

Grand Island
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Grand Island, NE 68803

Omaha
4900 Dodge Street
Omaha, NE 68132

EXECUTIVE OFFICERS
BNCCORP and Subsidiaries

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President and Chief Executive Officer

Timothy J. Franz, CPA (Inactive)
Chief Financial Officer

Shawn Cleveland, CPA
Chief Operating Officer, BNC National Bank

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

Mark E. Peiler, CFA
Senior Vice President - Chief Investment Officer

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