

1ST SOURCE CORP  
Form 10-K  
February 17, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2010
- OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-6233

1ST SOURCE CORPORATION  
(Exact name of registrant as specified in its charter)

Indiana  
(State or other jurisdiction of  
incorporation or  
organization)

35-1068133  
(I.R.S. Employer  
Identification No.)

100 North Michigan Street  
South Bend, Indiana  
(Address of principal executive  
offices)

46601  
(Zip Code)

Registrant's telephone number, including area code: (574) 235-2000  
Securities registered pursuant to Section 12(b) of the Act:

Title of each class  
Common Stock – without par value

Name of each exchange on which  
registered  
The NASDAQ Stock Market LLC

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of the voting common stock held by non-affiliates of the registrant as of June 30, 2010 was \$230,698,887

The number of shares outstanding of each of the registrant's classes of stock as of February 14, 2011:  
Common Stock, without par value – 24,299,962 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the annual proxy statement for the 2011 annual meeting of shareholders to be held April 21, 2011, are incorporated by reference into Part III.

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Part I

Item 1. Business.

1st Source Corporation

1st Source Corporation, an Indiana corporation incorporated in 1971, is a bank holding company headquartered in South Bend, Indiana that provides, through our subsidiaries (collectively referred to as "1st Source"), a broad array of financial products and services. 1st Source Bank ("Bank"), our banking subsidiary, offers commercial and consumer banking services, trust and investment management services, and insurance to individual and business clients through most of our 76 banking center locations in 17 counties in Indiana and Michigan. 1st Source Bank's Specialty Finance Group, with 22 locations nationwide, offers specialized financing services for new and used private and cargo aircraft, automobiles and light trucks for leasing and rental agencies, medium and heavy duty trucks, construction equipment, and environmental equipment. While concentrated in certain equipment types, we serve a diverse client base. We are not dependent upon any single industry or client. At December 31, 2010, we had consolidated total assets of \$4.45 billion, loans and leases of \$3.07 billion, deposits of \$3.62 billion, and total shareholders' equity of \$486.38 million.

Our principal executive office is located at 100 North Michigan Street, South Bend, Indiana 46601 and our telephone number is 574 235-2000. Access to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports is available, free of charge, at [www.1stsource.com](http://www.1stsource.com) soon after the material is electronically filed with the Securities and Exchange Commission (SEC).

1st Source Bank

1st Source Bank is a wholly owned subsidiary of 1st Source Corporation that offers a broad range of consumer and commercial banking services through its lending operations, retail branches, and fee based businesses.

**Commercial, Agricultural, and Real Estate Loans** — 1st Source Bank provides commercial, small business, agricultural, and real estate loans to primarily privately owned business clients mainly located within our regional market area. Loans are made for a wide variety of general corporate purposes, including financing for industrial and commercial properties, financing for equipment, inventories and accounts receivable, and acquisition financing. Other services include commercial leasing and cash management services.

**Consumer Services** — 1st Source Bank provides a full range of consumer banking services, including checking accounts, on-line banking including bill payment, telephone banking, savings programs, installment and real estate loans, home equity loans and lines of credit, drive-through and night deposit services, safe deposit facilities, automated teller machines, debit and credit card services, financial literacy seminars and brokerage services.

**Trust Services** — 1st Source Bank provides a wide range of trust, investment, agency, and custodial services for individual, corporate, and not-for-profit clients. These services include the administration of estates and personal trusts, as well as the management of investment accounts for individuals, employee benefit plans, and charitable foundations.

**Specialty Finance Group Services** — 1st Source Bank, through its Specialty Finance Group, provides a broad range of comprehensive equipment loan and lease finance products addressing the financing needs of a broad array of companies. This group can be broken down into five areas: auto and light trucks; environmental equipment; medium and heavy duty trucks; new and used aircraft; and construction equipment.

The auto and light truck division consists of financings to automobile rental and leasing companies, light truck rental and leasing companies, and special purpose vehicles. The auto and light truck finance receivables generally range from \$100,000 to \$14 million with fixed or variable interest rates and terms of one to five years.

Environmental equipment financing handles trash and recycling equipment for municipalities and private businesses as well as equipment for landfills. Receivables generally range from \$50,000 to \$4 million with fixed or variable interest rates and terms of one to seven years.

The medium and heavy duty truck division provides financing for highway tractors and trailers and delivery trucks to the commercial trucking industry. Medium and heavy duty truck finance receivables generally range from \$500,000 to \$6 million with fixed or variable interest rates and terms of three to seven years.

Aircraft financing consists of financings for new and used general aviation aircraft (including helicopters) for private and corporate aircraft users, aircraft distributors and dealers, air charter operators, air cargo carriers, and other aircraft operators. We have selectively entered the international business aircraft markets, primarily Brazil and Mexico, on a limited basis where desirable aircraft financing opportunities exist. Aircraft finance receivables generally range from \$500,000 to \$14 million with fixed or variable interest rates and terms of one to ten years.

Construction equipment financing includes financing of equipment (i.e., asphalt and concrete plants, bulldozers, excavators, cranes, and loaders, etc.) to the construction industry. Construction equipment finance receivables generally range from \$100,000 to \$14 million with fixed or variable interest rates and terms of three to six years.

We also generate equipment rental income through the leasing of construction equipment, medium and heavy duty trucks, automobiles, and other equipment to clients through operating leases.

#### Specialty Finance Group Subsidiaries

The Specialty Finance Group also consists of separate wholly owned subsidiaries of 1st Source Bank which include: Michigan Transportation Finance Corporation, 1st Source Specialty Finance, Inc., SFG Aircraft, Inc., 1st Source Intermediate Holding, LLC, SFG Commercial Aircraft Leasing, Inc., and SFG Equipment Leasing Corporation I.

#### First National Bank, Valparaiso

First National Bank, Valparaiso (First National) was a wholly owned subsidiary of 1st Source Corporation that was acquired on May 31, 2007 for \$134.19 million. First National was a full service bank with 16 banking facilities, as of December 31, 2007, located in Porter and LaPorte Counties of Indiana. On June 6, 2008, First National was merged with 1st Source Bank.

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### 1st Source Insurance, Inc.

1st Source Insurance, Inc. is a wholly owned subsidiary of 1st Source Bank that provides insurance products and services to individuals and businesses covering corporate and personal property, casualty insurance, and individual and group health and life insurance. 1st Source Insurance, Inc. has seven offices.

### 1st Source Corporation Investment Advisors, Inc.

1st Source Corporation Investment Advisors, Inc. (Investment Advisors) is a wholly owned subsidiary of 1st Source Bank that provides investment advisory services to trust and investment clients of 1st Source Bank and to Wasatch Advisors, Inc., the investment advisor of the Wasatch Mutual Fund family. Investment Advisors is registered as an investment advisor with the Securities and Exchange Commission under the Investment Advisors Act of 1940. Investment Advisors serves strictly in an advisory capacity and, as such, does not hold any client securities.

### Other Consolidated Subsidiaries

We have other subsidiaries that are not significant to the consolidated entity.

### 1st Source Capital Trust IV and 1st Source Master Trust

Our unconsolidated subsidiaries include 1st Source Capital Trust IV and 1st Source Master Trust. These subsidiaries were created for the purposes of issuing \$30.00 million and \$57.00 million of trust preferred securities, respectively, and lending the proceeds to 1st Source. We guarantee, on a limited basis, payments of distributions on the trust preferred securities and payments on redemption of the trust preferred securities.

### Competition

The activities in which we and the Bank engage in are highly competitive. Our businesses and the geographic markets we serve require us to compete with other banks, some of which are affiliated with large bank holding companies headquartered outside of our principal market. We generally compete on the basis of client service and responsiveness to client needs, available loan and deposit products, the rates of interest charged on loans and leases, the rates of interest paid for funds, other credit and service charges, the quality of services rendered, the convenience of banking facilities, and in the case of loans and leases to large commercial borrowers, relative lending limits.

In addition to competing with other banks within our primary service areas, the Bank also competes with other financial service companies, such as credit unions, industrial loan associations, securities firms, insurance companies, small loan companies, finance companies, mortgage companies, real estate investment trusts, certain governmental agencies, credit organizations, and other enterprises.

Additional competition for depositors' funds comes from United States Government securities, private issuers of debt obligations, and suppliers of other investment alternatives for depositors. Many of our non-bank competitors are not subject to the same extensive Federal regulations that govern bank holding companies and banks. Such non-bank competitors may, as a result, have certain advantages over us in providing some services.

We compete against these financial institutions by being convenient to do business with, and by taking the time to listen and understand our clients' needs. We deliver personalized, one on one banking through knowledgeable local members of the community, offering a full array of products and highly personalized services. We rely on our history and our reputation in northern Indiana dating back to 1863.

## Employees

At December 31, 2010, we had approximately 1,160 employees on a full-time equivalent basis. We provide a wide range of employee benefits and consider employee relations to be good.

## Regulation and Supervision

General — 1st Source and the Bank are extensively regulated under Federal and State law. To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions. Any change in applicable laws or regulations may have a material effect on our business and our prospective business. Our operations may be affected by legislative changes and by the policies of various regulatory authorities. We are unable to predict the nature or the extent of the effects on our business and earnings that fiscal or monetary policies, economic controls, or new Federal or State legislation may have in the future.

We are a registered bank holding company under the Bank Holding Company Act of 1956 (BHCA) and, as such, we are subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (Federal Reserve). We are required to file annual reports with the Federal Reserve and to provide the Federal Reserve such additional information as it may require.

1st Source Bank, as an Indiana state bank and member of the Federal Reserve System, is supervised by the Indiana Department of Financial Institutions (DFI) and the Federal Reserve. As such, 1st Source Bank is regularly examined by and subject to regulations promulgated by the DFI and the Federal Reserve. Because the Federal Deposit Insurance Corporation (FDIC) provides deposit insurance to 1st Source Bank, we are also subject to supervision and regulation by the FDIC (even though the FDIC is not our primary Federal regulator).

Bank Holding Company Act — Under the BHCA, as amended, our activities are limited to business so closely related to banking, managing, or controlling banks as to be a proper incident thereto. We are also subject to capital requirements applied on a consolidated basis in a form substantially similar to those required of the Bank. The BHCA also requires a bank holding company to obtain approval from the Federal Reserve before (i) acquiring, or holding more than 5% voting interest in any bank or bank holding company, (ii) acquiring all or substantially all of the assets of another bank or bank holding company, or (iii) merging or consolidating with another bank holding company.

The BHCA also restricts non-bank activities to those which, by statute or by Federal Reserve regulation or order, have been identified as activities closely related to the business of banking or of managing or controlling banks. As discussed below, the Gramm-Leach-Bliley Act, which was enacted in 1999, established a new type of bank holding company known as a "financial holding company" that has powers that are not otherwise available to bank holding companies.

The Federal Deposit Insurance Corporation Improvement Act of 1991 — The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) was adopted to supervise and regulate a wide variety of banking issues. In general, FDICIA provided for the recapitalization of the former Bank Insurance Fund, deposit insurance reform, including the implementation of risk-based deposit insurance premiums, the establishment of five capital levels for financial institutions ("well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized") that would impose more scrutiny and restrictions on less capitalized institutions, along with a number of other supervisory and regulatory issues. At December 31, 2010, the Bank was categorized as "well capitalized," meaning that our total risk-based capital ratio exceeded 10.00%, our Tier 1 risk-based capital ratio exceeded 6.00%, our leverage ratio exceeded 5.00%, and we are not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure.





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Federal Deposit Insurance Reform Act — On February 1, 2006, Congress approved the Federal Deposit Insurance Reform Act of 2005 (FDIRA). Among other things, the FDIRA provides for the merger of the Bank Insurance Fund with the Savings Association Insurance Fund and for an immediate increase in Federal deposit insurance for certain retirement accounts up to \$250,000. The statute further provides for the indexing of the maximum deposit insurance coverage for all types of deposit accounts in the future to account for inflation. The FDIRA also requires the FDIC to provide certain banks and thrifts that were in existence prior to December 31, 1996 with one-time credits against future premiums based on the amount of their payments to the Bank Insurance Fund or Savings Association Insurance Fund prior to that date.

FDIC Deposit Insurance Assessments — On October 16, 2008, in response to the problems facing the financial markets and the economy, the Federal Deposit Insurance Corporation published a restoration plan (Restoration Plan) designed to replenish the Deposit Insurance Fund (DIF) such that the reserve ratio would return to 1.15 percent within five years. On December 16, 2008, the FDIC adopted a final rule increasing risk-based assessment rates uniformly by seven basis points, on an annual basis, for the first quarter 2009.

On February 27, 2009, the FDIC concluded that the problems facing the financial services sector and the economy at large constituted extraordinary circumstances and amended the Restoration Plan and extended the time within which the reserve ratio would return to 1.15 percent from five to seven years (Amended Restoration Plan). In May 2009, Congress amended the statutory provision governing establishment and implementation of a Restoration Plan to allow the FDIC eight years to bring the reserve ratio back to 1.15 percent, absent extraordinary circumstances.

On May 22, 2009, the FDIC adopted a final rule imposing a five basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009. The special assessment was collected on September 30, 2009.

In a final rule issued on September 29, 2009, the FDIC amended the Amended Restoration Plan as follows:

- The period of the Amended Restoration Plan was extended from seven to eight years.
- The FDIC announced that it will not impose any further special assessments under the final rule it adopted in May 2009.
- The FDIC announced plans to maintain assessment rates at their current levels through the end of 2010. The FDIC also immediately adopted a uniform three basis point increase in assessment rates effective January 1, 2011 to ensure that the DIF returns to 1.15 percent within the Amended Restoration Plan period of eight years.
- The FDIC announced that, at least semi-annually following the adoption of the Amended Restoration Plan, it will update its loss and income projections for the DIF. The FDIC also announced that it may, if necessary, adopt a new rule prior to the end of the eight-year period to increase assessment rates in order to return the reserve ratio to 1.15 percent.

On November 12, 2009, the FDIC adopted a final rule to require insured institutions to prepay their quarterly risk-based deposit insurance assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012, on December 30, 2009. Our payment was \$20.26 million.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which was signed into law on July 21, 2010, changes how the FDIC will calculate future deposit insurance premiums payable by insured depository institutions. The Dodd-Frank Act directs the FDIC to amend its assessment regulations so that future assessments will generally be based upon a depository institution's average total consolidated assets minus the average tangible equity

of the insured depository institution during the assessment period, whereas assessments were previously based on the amount of an institution's insured deposits. The minimum deposit insurance fund rate will increase from 1.15% to 1.35% by September 30, 2020, and the cost of the increase will be borne by depository institutions with assets of \$10 billion or more.

The Dodd-Frank Act also provides the FDIC with discretion to determine whether to pay rebates to insured depository institutions when its deposit insurance reserves exceed certain thresholds. Previously, the FDIC was required to give rebates to depository institutions equal to the excess once the reserve ratio exceeded 1.50%, and was required to rebate 50% of the excess over 1.35% but not more than 1.5% of insured deposits. The FDIC adopted a final rule on February 7, 2011 that implements these provisions of the Dodd-Frank Act.

Temporary Liquidity Guarantee Program — On November 21, 2008, the FDIC Board of Directors adopted a final rule implementing the Temporary Liquidity Guarantee Program (TLGP). The TLGP consists of two basic components: a guarantee of newly issued senior unsecured debt of banks, thrifts, and certain holding companies (the debt guarantee program) and full guarantee of non-interest bearing deposit transaction accounts, such as business payroll accounts, regardless of dollar amount (the transaction account guarantee program). The purpose of the guarantee of transaction accounts and the debt guarantee was to reduce funding costs and allow banks and thrifts to increase lending to consumers and businesses. All insured depository institutions were automatically enrolled in both programs unless they elected to opt out by a specified date. 1st Source did not elect to opt out and thus participated in both programs.

As originally adopted, the transaction account guarantee program was to terminate on December 31, 2009, although the FDIC subsequently extended the program through December 31, 2010. The Dodd-Frank Act, which was adopted on July 21, 2010, included a provision that effectively replaced the transaction account guarantee program and extended the unlimited FDIC guarantee of noninterest bearing transaction accounts through December 31, 2012 for all insured depository institutions, not just those that elect to participate. Also, the Dodd-Frank Act provision, unlike the transaction account guarantee program, does not include low-interest NOW accounts within the definition of noninterest-bearing transaction accounts, and such accounts are therefore not covered by unlimited deposit insurance coverage. A subsequent amendment to the Dodd-Frank Act that became effective on December 31, 2010 extended unlimited deposit insurance coverage for "Interest on Lawyers Trust Accounts" through December 31, 2012.

The debt guarantee program under the TLGP initially permitted participating entities to issue FDIC-guaranteed senior unsecured debt until June 30, 2009, with the FDIC's guarantee for such debt to expire on the earlier of the maturity of the debt (or the conversion date, for mandatory convertible debt) or June 30, 2012. On March 17, 2009, the FDIC extended the debt guarantee portion of the TLGP from June 30, 2009 to October 31, 2009 and imposed a surcharge on debt issued with a maturity of one year or more beginning in the second quarter to gradually phase out the program. There were no further extensions of the debt guarantee program, and the program concluded on October 31, 2009. The FDIC's guarantee of debt issued before that date will expire no later than December 31, 2012.

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Emergency Economic Stabilization Act of 2008 — On October 3, 2008, President George W. Bush signed the Emergency Economic Stabilization Act of 2008 (EESA). This Act temporarily increased the standard maximum deposit insurance amount from \$100,000 to \$250,000 effective immediately. This temporary increase in the scope of deposit insurance coverage was originally set to expire on December 31, 2013, but the Dodd-Frank Act made this temporary increase permanent.

Under the Troubled Asset Relief Program established by EESA, the U.S. Treasury Department announced a Capital Purchase Program (CPP). CPP is designed to encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. businesses and consumers and support the U.S. economy. Under the program, Treasury will purchase up to \$250 billion of senior preferred shares on standardized terms as described in the program's term sheet. The program is available to qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities that elect submitted applications to Treasury by November 14, 2008. EESA provides for Treasury to determine an applicant's eligibility to participate in the CPP after consulting with the appropriate federal banking agency.

1st Source submitted an application to participate in the CPP and obtained Treasury approval on December 11, 2008. On January 23, 2009, 1st Source issued preferred stock valued at \$111.00 million and a warrant to acquire 837,947 shares of its common stock to Treasury pursuant to the CPP. The warrant is exercisable at any time during the ten-year period following issuance at an exercise price of \$19.87 per share. On December 29, 2010, 1st Source redeemed all of the preferred stock issued to the Treasury under CPP for \$111.68 million, which included accrued and unpaid dividends payable to Treasury on the preferred stock. The warrant remains outstanding as of December 31, 2010.

Securities and Exchange Commission (SEC) and The Nasdaq Stock Market (Nasdaq) — We are under the jurisdiction of the SEC and certain state securities commissions for matters relating to the offering and sale of our securities and our investment advisory services. We are subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the SEC. We are listed on the Nasdaq Global Select Market under the trading symbol "SRCE," and we are subject to the rules of Nasdaq for listed companies.

Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 — Congress enacted the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Act) in September 1994. Beginning in September 1995, bank holding companies have the right to expand, by acquiring existing banks, into all states, even those which had theretofore restricted entry. The legislation also provides that, subject to future action by individual states, a holding company has the right to convert the banks which it owns in different states to branches of a single bank. The states of Indiana and Michigan have adopted the interstate branching provisions of the Interstate Act.

Economic Growth and Regulatory Paperwork Reduction Act of 1996 — The Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) was signed into law on September 30, 1996. Among other things, EGRPRA streamlined the non-banking activities application process for well-capitalized and well-managed bank holding companies.

Gramm-Leach-Bliley Act of 1999 — The Gramm-Leach-Bliley Act of 1999 (GLBA) is intended to modernize the banking industry by removing barriers to affiliation among banks, insurance companies, the securities industry, and other financial service providers. It provides financial organizations with the flexibility of structuring such affiliations through a holding company structure or through a financial subsidiary of a bank, subject to certain limitations. The GLBA establishes a new type of bank holding company, known as a financial holding company, which may engage in an expanded list of activities that are "financial in nature," which include securities and insurance brokerage, securities underwriting, insurance underwriting, and merchant banking. The GLBA also sets forth a system of functional regulation that makes the Federal Reserve the "umbrella supervisor" for holding companies, while providing for the

supervision of the holding company's subsidiaries by other Federal and state agencies. A bank holding company may not become a financial holding company if any of its subsidiary financial institutions are not well-capitalized or well-managed. Further, each bank subsidiary of the holding company must have received at least a satisfactory Community Reinvestment Act (CRA) rating. The GLBA also expands the types of financial activities a national bank may conduct through a financial subsidiary, addresses state regulation of insurance, generally prohibits unitary thrift holding companies organized after May 4, 1999 from participating in new activities that are not financial in nature, provides privacy protection for nonpublic customer information of financial institutions, modernizes the Federal Home Loan Bank system, and makes miscellaneous regulatory improvements. The Federal Reserve and the Secretary of the Treasury must coordinate their supervision regarding approval of new financial activities to be conducted through a financial holding company or through a financial subsidiary of a bank. While the provisions of the GLBA regarding activities that may be conducted through a financial subsidiary directly apply only to national banks, those provisions indirectly apply to state-chartered banks. In addition, the Bank is subject to other provisions of the GLBA, including those relating to CRA and privacy, regardless of whether we elect to become a financial holding company or to conduct activities through a financial subsidiary. We do not currently intend to file notice with the Board to become a financial holding company or to engage in expanded financial activities through a financial subsidiary.

**Financial Privacy** — In accordance with the GLBA, Federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about customers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. The privacy provisions of the GLBA affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

**USA Patriot Act of 2001** — The USA Patriot Act of 2001 (USA Patriot Act) was signed into law following the terrorist attacks of September 11, 2001. The USA Patriot Act is comprehensive anti-terrorism legislation that, among other things, substantially broadened the scope of anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations on financial institutions.

The regulations adopted by the United States Treasury Department under the USA Patriot Act require financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering, and terrorist financing. Additionally, the regulations require that we, upon request from the appropriate Federal regulatory agency, provide records related to anti-money laundering, perform due diligence of private banking and correspondent accounts, establish standards for verifying customer identity, and perform other related duties.

Failure of a financial institution to comply with the USA Patriot Act's requirements could have serious legal and reputational consequences for the institution.

**Regulations Governing Capital Adequacy** — The Federal bank regulatory agencies use capital adequacy guidelines in their examination and regulation of bank holding companies and banks. If capital falls below the minimum levels established by these guidelines, a bank holding company or bank will be required to submit an acceptable plan for achieving compliance with the capital guidelines and will be subject to denial of applications and appropriate supervisory enforcement actions. The various regulatory capital requirements that we are subject to are disclosed in Part II, Item 8, Financial Statements and Supplementary Data — Note 20 of the Notes to Consolidated Financial Statements. Our management believes that the risk-weighting of assets and the risk-based capital guidelines do not have a material adverse impact on our operations or on the operations of the Bank.

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Community Reinvestment Act — The Community Reinvestment Act of 1977 requires that, in connection with examinations of financial institutions within their jurisdiction, the Federal banking regulators must evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those banks. Federal banking regulators are required to consider a financial institution's performance in these areas as they review applications filed by the institution to engage in mergers or acquisitions or to open a branch or facility.

Regulations Governing Extensions of Credit — 1st Source Bank is subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to 1st Source or our subsidiaries, or investments in our securities and on the use of our securities as collateral for loans to any borrowers. These regulations and restrictions may limit our ability to obtain funds from the Bank for our cash needs, including funds for acquisitions and for payment of dividends, interest and operating expenses. Further, the BHCA, certain regulations of the Federal Reserve, state laws and many other Federal laws govern the extensions of credit and generally prohibit a bank from extending credit, engaging in a lease or sale of property, or furnishing services to a customer on the condition that the customer obtain additional services from the bank's holding company or from one of its subsidiaries.

1st Source Bank is also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders, or any related interest of such persons. Extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, and subject to credit underwriting procedures that are at least as stringent as those prevailing at the time for comparable transactions with non affiliates, and (ii) must not involve more than the normal risk of repayment or present other unfavorable features. The Bank is also subject to certain lending limits and restrictions on overdrafts to such persons.

Reserve Requirements — The Federal Reserve requires all depository institutions to maintain reserves against their transaction account deposits. The Bank must maintain reserves of 3.00% against net transaction accounts greater than \$10.70 million and up to \$58.80 million (subject to adjustment by the Federal Reserve) and reserves of 10.00% must be maintained against that portion of net transaction accounts in excess of \$58.80 million.

Dividends — The ability of the Bank to pay dividends is limited by state and Federal laws and regulations that require 1st Source Bank to obtain the prior approval of the DFI and the Federal Reserve Bank of Chicago before paying a dividend that, together with other dividends it has paid during a calendar year, would exceed the sum of its net income for the year to date combined with its retained net income for the previous two years. The amount of dividends the Bank may pay may also be limited by certain covenant agreements and by the principles of prudent bank management. See Part II, Item 5, Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities for further discussion of dividend limitations.

Monetary Policy and Economic Control — The commercial banking business in which we engage is affected not only by general economic conditions, but also by the monetary policies of the Federal Reserve. Changes in the discount rate on member bank borrowing, availability of borrowing at the "discount window," open market operations, the imposition of changes in reserve requirements against member banks deposits and assets of foreign branches, and the imposition of, and changes in, reserve requirements against certain borrowings by banks and their affiliates are some of the instruments of monetary policy available to the Federal Reserve. These monetary policies are used in varying combinations to influence overall growth and distributions of bank loans, investments, and deposits, and such use may affect interest rates charged on loans and leases or paid on deposits. The monetary policies of the Federal Reserve have had a significant effect on the operating results of commercial banks and are expected to do so in the future. The monetary policies of the Federal Reserve are influenced by various factors, including economic growth, inflation, unemployment, short-term and long-term changes in the international trade balance, and in the fiscal policies of the U.S. Government. Future monetary policies and the effect of such policies on our future business and earnings, and the effect on the future business and earnings of the Bank cannot be predicted.

Sarbanes-Oxley Act of 2002 — On July 30, 2002, the Sarbanes-Oxley Act of 2002 (SOA) was signed into law. The SOA's stated goals include enhancing corporate responsibility, increasing penalties for accounting and auditing improprieties at publicly traded companies and protecting investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The SOA generally applies to all companies that file or are required to file periodic reports with the SEC under the Securities Exchange Act of 1934 (Exchange Act.)

Among other things, the SOA creates the Public Company Accounting Oversight Board as an independent body subject to SEC supervision with responsibility for setting auditing, quality control, and ethical standards for auditors of public companies. The SOA also requires public companies to make faster and more-extensive financial disclosures, requires the chief executive officer and the chief financial officer of public companies to provide signed certifications as to the accuracy and completeness of financial information filed with the SEC, and provides enhanced criminal and civil penalties for violations of the Federal securities laws.

The SOA also addresses functions and responsibilities of audit committees of public companies. The statute, by mandating certain stock exchange listing rules, makes the audit committee directly responsible for the appointment, compensation, and oversight of the work of the company's outside auditor, and requires the auditor to report directly to the audit committee. The SOA authorizes each audit committee to engage independent counsel and other advisors, and requires a public company to provide the appropriate funding, as determined by its audit committee, to pay the company's auditors and any advisors that its audit committee retains. The SOA also requires public companies to prepare an internal control report and assessment by management, along with an attestation to this report prepared by the company's registered public accounting firm, in their annual reports to stockholders.

Secure and Fair Enforcement for Mortgage Licensing Act — The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act) establishes a nationwide licensing and registration system for mortgage loan originators. The S.A.F.E. Act requires an employee of a bank, savings association or credit union and certain of their subsidiaries that are regulated by a federal banking agency (agency-regulated institutions) who acts as a residential mortgage loan originator to register with the Nationwide Mortgage Licensing System and Registry (NMLS), obtain a unique identifier, and maintain this registration.

The federal banking agencies adopted a final rule that was published on August 23, 2010 to implement these provisions. The final rule requires, among other things, that a loan originator submit to the NMLS certain information concerning his or her personal history and experience, undergo an FBI criminal background check, and authorize the NMLS to obtain information related to any administrative, civil, or criminal findings by any governmental agency regarding the loan originator. All loan originators employed by agency-regulated institutions must register with the NMLS within 180 days of the date on which this registration system becomes operational, which the banking agencies expect to occur on or around January 31, 2011.

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Dodd-Frank Wall Street Reform and Consumer Protection Act — On July 21, 2010, President Obama signed into law the Dodd-Frank Act, which significantly changes the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes provisions affecting large and small financial institutions alike, including several provisions that will profoundly affect how community banks, thrifts, and small bank and thrift holding companies will be regulated in the future. Among other things, these provisions abolish the Office of Thrift Supervision and transfer its functions to the other federal banking agencies, relax rules regarding interstate branching, allow financial institutions to pay interest on business checking accounts, and impose new capital requirements on bank and thrift holding companies.

The Dodd-Frank Act also makes permanent the temporary increase in deposit insurance coverage from \$100,000 to \$250,000 that was included in the EESA, and extends until December 31, 2012 the period during which the FDIC will provide unlimited deposit insurance for "noninterest-bearing transaction accounts".

The Dodd-Frank Act also establishes the Bureau of Consumer Financial Protection as an independent entity within the Federal Reserve, which will be given the authority to promulgate consumer protection regulations applicable to all entities offering consumer financial services or products, including banks. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting, among other things, originator compensation, minimum repayment standards, and pre-payment penalties. The Dodd-Frank Act contains numerous other provisions affecting financial institutions of all types, many of which may have an impact on our operating environment in substantial and unpredictable ways.

Because many of the regulations required to implement the Dodd-Frank Act have not yet been issued, the statute's effect on the financial services industry in general, and on us in particular, is uncertain at this time. The Dodd-Frank Act is likely to affect our cost of doing business, however, and may limit or expand the scope of our permissible activities and affect the competitive balance within our industry and market areas. Our management is actively reviewing the provisions of the Dodd-Frank Act and assessing its probable impact on our business, financial condition, and results of operations.

Pending Legislation — Because of concerns relating to competitiveness and the safety and soundness of the banking industry, Congress often considers a number of wide-ranging proposals for altering the structure, regulation, and competitive relationships of the nation's financial institutions. We cannot predict whether or in what form any proposals will be adopted or the extent to which our business may be affected.

Item 1A. Risk Factors.

An investment in our common stock is subject to risks inherent to our business. The material risks and uncertainties that we believe affect us are described below. See "Forward Looking Statements" under Item 7 of this report for a discussion of other important factors that can affect our business.

Fluctuations in interest rates could reduce our profitability and affect the value of our assets — Like other financial institutions, we are subject to interest rate risk. Our primary source of income is net interest income, which is the difference between interest earned on loans and leases and investments, and interest paid on deposits and borrowings. We expect that we will periodically experience imbalances in the interest rate sensitivities of our assets and liabilities and the relationships of various interest rates to each other. Over any defined period of time, our interest-earning assets may be more sensitive to changes in market interest rates than our interest-bearing liabilities, or vice-versa. In addition, the individual market interest rates underlying our loan and lease and deposit products may not change to the same degree over a given time period. In any event, if market interest rates should move contrary to our position,



earnings may be negatively affected. In addition, loan and lease volume and quality and deposit volume and mix can be affected by market interest rates as can the businesses of our clients. Changes in levels of market interest rates could have a material adverse effect on our net interest spread, asset quality, origination volume, and overall profitability.

Market interest rates are beyond our control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, may negatively affect our ability to originate loans and leases, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately could affect our earnings.

Competition from other financial services providers could adversely impact our results of operations — The banking and financial services business is highly competitive. We face competition in making loans and leases, attracting deposits and providing insurance, investment, trust, and other financial services. Increased competition in the banking and financial services businesses may reduce our market share, impair our growth or cause the prices we charge for our services to decline. Our results of operations may be adversely impacted in future periods depending upon the level and nature of competition we encounter in our various market areas.

We are dependent upon the services of our management team — Our future success and profitability is substantially dependent upon our management and the banking abilities of our senior executives. We believe that our future results will also depend in part upon our ability to attract and retain highly skilled and qualified management. We are especially dependent on a limited number of key management personnel, many of whom do not have employment agreements with us. The loss of the chief executive officer and other senior management and key personnel could have a material adverse impact on our operations because other officers may not have the experience and expertise to readily replace these individuals. Many of these senior officers have primary contact with our clients and are important in maintaining personalized relationships with our client base. The unexpected loss of services of one or more of these key employees could have a material adverse effect on our operations and possibly result in reduced revenues if we were unable to find suitable replacements promptly. Competition for senior personnel is intense, and we may not be successful in attracting and retaining such personnel. Changes in key personnel and their responsibilities may be disruptive to our businesses and could have a material adverse effect on our businesses, financial condition, and results of operations.

Technology security breaches and constant technological change — Any compromise of our security could deter our clients from using our banking services that involve the transmission of confidential information. We rely on security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not protect our systems from compromises or breaches of our security measures that could result in damage to our reputation and business.

The financial services industry is constantly undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better service clients and reduce costs. Our future success depends, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands, as well as create additional efficiencies within our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services quickly or be successful in marketing these products and services to our clients. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

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We are subject to credit risks relating to our loan and lease portfolios — We have certain lending policies and procedures in place that are designed to optimize loan and lease income within an acceptable level of risk. Our management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing our management with frequent reports related to loan and lease production, loan quality, concentrations of credit, loan and lease delinquencies, and nonperforming and potential problem loans and leases. Diversification in the loan and lease portfolios is a means of managing risk associated with fluctuations and economic conditions.

We maintain an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to our management. The loan and lease review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as our policies and procedures.

Commercial and commercial real estate loans generally involve higher credit risks than residential real estate and consumer loans. Because payments on loans secured by commercial real estate or equipment are often dependent upon the successful operation and management of the underlying assets, repayment of such loans may be influenced to a great extent by conditions in the market or the economy. We seek to minimize these risks through our underwriting standards. We obtain financial information and perform credit risk analysis on our customers. Credit criteria may include, but are not limited to, assessments of income, cash flows, and net worth; asset ownership; bank and trade credit reference; credit bureau report; and operational history.

Commercial real estate or equipment loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and generate positive cash flows. Our management examines current and projected cash flows of the borrower to determine the ability of the borrower to repay their obligations as agreed. Underwriting standards are designed to promote relationship banking rather than transactional banking. Most commercial and industrial loans are secured by the assets being financed or other business assets; however, some loans may be made on an unsecured basis. Our credit policy sets different maximum exposure limits both by business sector and our current and historical relationship and previous experience with each customer.

We offer both fixed-rate and adjustable-rate consumer mortgage loans secured by properties, substantially all of which are located in our primary market area. Adjustable-rate mortgage loans help reduce our exposure to changes in interest rates; however, during periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase as a result of repricing and the increased payments required from the borrower. Additionally, most residential mortgages are sold into the secondary market and serviced by our principal banking subsidiary, 1st Source Bank.

Consumer loans are primarily all other non-real estate loans to individuals in our regional market area. Consumer loans can entail risk, particularly in the case of loans that are unsecured or secured by rapidly depreciating assets. In these cases, any repossessed collateral may not provide an adequate source of repayment of the outstanding loan balance. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness, or personal bankruptcy.

The 1st Source Specialty Finance Group loan and lease portfolio consists of commercial loans and leases secured by construction and transportation equipment, including aircraft, autos, trucks, and vans. Finance receivables for this Group generally provide for monthly payments and may include prepayment penalty provisions.

Our construction and transportation related businesses could be adversely affected by slow downs in the economy. Clients who rely on the use of assets financed through the Specialty Finance Group to produce income could be

negatively affected, and we could experience substantial loan and lease losses. By the nature of the businesses these clients operate in, we could be adversely affected by rapid increases of fuel costs. Since some of the relationships in these industries are large (up to \$25 million), a slow down could have a significant adverse impact on our performance.

Our construction and transportation related businesses could be adversely impacted by the negative effects caused by high fuel costs, terrorist and other potential attacks, and other destabilizing events. These factors could contribute to the deterioration of the quality of our loan and lease portfolio, as they could have a negative impact on the travel and transportation sensitive businesses for which our specialty finance businesses provide financing.

In addition, our leasing and equipment financing activity is subject to the risk of cyclical downturns, industry concentration and clumping, and other adverse economic developments affecting these industries and markets. This area of lending, with transportation in particular, is dependent upon general economic conditions and the strength of the travel, construction, and transportation industries.

Our reserve for loan and lease losses may prove to be insufficient to absorb probable losses in our loan and lease portfolio — In the financial services industry, there is always a risk that certain borrowers may not repay borrowings. The determination of the appropriate level of the reserve for loan and lease losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Our reserve for loan and lease losses may not be sufficient to cover the loan and lease losses that we may actually incur. If we experience defaults by borrowers in any of our businesses, our earnings could be negatively affected. Changes in local economic conditions could adversely affect credit quality, particularly in our local business loan and lease portfolio. Changes in national or international economic conditions could also adversely affect the quality of our loan and lease portfolio and negate, to some extent, the benefits of national or international diversification through our Specialty Finance Group's portfolio. In addition, bank regulatory agencies periodically review our reserve for loan and lease losses and may require an increase in the provision for possible loan and lease losses or the recognition of further loan or lease charge-offs based upon their judgments, which may be different from ours.

The soundness of other financial institutions could adversely affect us — Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due us. Any such losses could have a material adverse effect on our financial condition and results of operations.

Our investments in municipalities could have a negative impact — As a result of recent economic conditions, some municipalities are struggling to meet financial obligations. We have certain municipal investment securities which are subject to credit risk if the municipalities are unable to meet their obligations to us. In addition, certain bond insurers have filed bankruptcy in recent months. Although we believe the municipalities will be able to meet their obligations, there can be no certainty regarding future results.

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We could have liquidity risks associated with our Indiana public fund deposits — The State of Indiana recently changed the law governing the collateralization of public fund deposits. Under the new law, the Indiana Board for Depositories (IBFD) that administers the Public Deposit Insurance Fund (PDIF) will determine which financial institutions are required to pledge collateral and may prohibit certain institutions from holding Indiana public funds. The IBFD will determine which financial institutions are required to pledge collateral based on the strength of their financial ratings. We have been informed by the IBFD that no collateral is required at this time and the next evaluation will occur on or before March 31, 2011. However, pending legislation could alter this requirement in the future and adversely impact our liquidity.

Adverse changes in economic conditions could impair our financial condition and results of operations — We are impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, unemployment, and the strength of the U.S. economy and the local economies in which we operate, all of which are beyond our control. A deterioration in economic conditions could result in an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for our products and services.

We are subject to extensive government regulation and supervision — Our operations are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not security holders. These regulations affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible change. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulation or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs and limit the types of financial services and products we may offer. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.

We rely on dividends from our subsidiaries — Our parent company, 1st Source Corporation, receives substantially all of its revenue from dividends from our subsidiaries. These dividends are the principal source of funds to pay dividends on our common stock and interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that our subsidiaries may pay to our parent company. In the event our subsidiaries are unable to pay dividends to our parent company, we may not be able to service debt, pay obligations or pay dividends on our common stock. The inability to receive dividends from our subsidiaries could have a material adverse effect on our business, financial condition and results of operations.

Changes in accounting standards could impact reported earnings — Current accounting and tax rules, standards, policies and interpretations influence the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies and interpretations are constantly evolving and may change significantly over time. Events that may not have a direct impact on us, such as bankruptcy of major U.S. companies, have resulted in legislators, regulators, and authoritative bodies, such as the Financial Accounting Standards Board, the Securities and Exchange Commission, the Public Company Accounting Oversight Board and various taxing authorities, responding by adopting and/or proposing substantive revision to laws, regulations, rules, standards, policies and interpretations. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. A change in accounting standards may adversely affect reported financial condition and results of operations.

Our deposit insurance premiums could be higher in the future which will have an adverse effect on our future earnings — The FDIC expects a higher rate of insured institution failures in the next few years, which may result in a continued decline in the reserve ratio. Due to the continued failures of FDIC insured depository institutions, FDIC insurance premiums have increased. FDIC deposit insurance premiums may increase in the future, perhaps significantly, which will adversely impact our future earnings.

Item 1B. Unresolved Staff Comments.

None

Item 2. Properties.

Our headquarters building is located in downtown South Bend. The building is part of a larger complex, including a 300-room hotel and a 500-car parking garage. In 1982, we sold the building and entered into a leaseback agreement with the purchaser for a term of 30 years. The building is a structure of approximately 160,000 square feet, with 1st Source and our subsidiaries occupying approximately 65% of the available office space and approximately 35% subleased to unrelated tenants as of December 31, 2010.

In December 2010, we entered into a new 10.5 year lease on our headquarters building which became effective January 1, 2011. Pursuant to the new lease agreement, we are relieved of our responsibility for managing the building. Effective January 1, 2011, 1st Source will lease approximately 60% of the office space.

At December 31, 2010, we also owned property and/or buildings on which 54 of the 1st Source Bank's 76 banking centers were located, including the facilities in Allen, Elkhart, Fulton, Huntington, Kosciusko, LaPorte, Marshall, Porter, St. Joseph, Starke, and Wells Counties in the State of Indiana and Berrien and Cass Counties in the State of Michigan, as well as an operations center, warehouse, and our former headquarters building, which is utilized for additional business operations. The Bank leases additional property and/or buildings to and from third parties under lease agreements negotiated at arms-length.

Item 3. Legal Proceedings.

1st Source and our subsidiaries are involved in various legal proceedings incidental to the conduct of our businesses. Our management does not expect that the outcome of any such proceedings will have a material adverse effect on our consolidated financial position or results of operations.

Item 4. (Removed and Reserved).

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## Part II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is traded on the Nasdaq Global Select Market under the symbol "SRCE." The following table sets forth for each quarter the high and low sales prices for our common stock, as reported by Nasdaq, and the cash dividends paid per share for each quarter.

Common Stock Prices (quarter ended)	2010 Sales Price		Cash Dividends	2009 Sales Price		Cash Dividends
	High	Low	Paid	High	Low	Paid
March 31	\$18.74	\$14.25	\$.15	\$23.92	\$14.16	\$.14
June 30	20.36	16.58	.15	21.98	15.36	.14
September 30	18.99	15.98	.15	17.94	14.52	.15
December 31	20.75	17.01	.16	16.60	13.84	.16

As of February 14, 2011, there were 984 holders of record of 1st Source common stock

## Comparison of Five Year Cumulative Total Return\*

Among 1st Source, Morningstar Market Weighted NASDAQ Index\*\* and Peer Group Index\*\*\*

\* Assumes \$100 invested on December 31, 2005, in 1st Source Corporation common stock, NASDAQ market index, and peer group index.

\*\* The Morningstar Weighted NASDAQ Index Return is calculated using all companies which trade as NASD Capital Markets, NASD Global Markets or NASD Global Select. It includes both domestic and foreign companies. The index is weighted by the then current shares outstanding and assumes dividends reinvested. The return is calculated on a monthly basis.

\*\*\* The peer group is a market-capitalization-weighted stock index of 142 banking companies in Illinois, Indiana, Michigan, Ohio, and Wisconsin.

NOTE: Total return assumes reinvestment of dividends.

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The following table summarizes our share repurchase activity during the three months ended December 31, 2010.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs*	Maximum Number (or Approximate Dollar Value) of Shares that may yet be Purchased Under the Plans or Programs
October 01 - 31, 2010	9,400	17.85	9,400	1,259,812
November 01 - 30, 2010	21,295	18.48	21,295	1,238,517
December 01 - 31, 2010	145	20.62	145	1,238,372

\*1st Source maintains a stock repurchase plan that was authorized by the Board of Directors on April 26, 2007. Under the terms of the plan, 1st Source may repurchase up to 2,000,000 shares of its common stock when favorable conditions exist on the open market or through private transactions at various prices from time to time. Since the inception of the plan, 1st Source has repurchased a total of 761,628 shares.

Federal laws and regulations contain restrictions on the ability of 1st Source and the Bank to pay dividends. For information regarding restrictions on dividends, see Part I, Item 1, Business - Regulation and Supervision - Dividends and Part II, Item 8, Financial Statements and Supplementary Data - Note 20 of the Notes to Consolidated Financial Statements.

Due to restrictions to which we were subject as a participant in the Capital Purchase Program established by the U.S. Treasury Department under EESA, we were not permitted to pay cash in respect to the bonus awarded under the 1998 Performance Compensation Plan that was payable in 2010. Accordingly, the Executive Compensation and Human Resources Committee determined to issue shares of Common Stock in respect to such bonus that would have been payable to Christopher J. Murphy III, Chairman of the Board and Chief Executive Officer, issuing 10,323 shares of common stock to Mr. Murphy in February 2010. Such issuance will be presented to shareholders for ratification at the 2011 Annual Meeting. The issuance was exempt from registration under the Securities Act, among other reasons, because of the exemption afforded under Section 4(2) of the Securities Act.

## Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with our Consolidated Financial Statements and the accompanying notes presented elsewhere herein.

(Dollars in thousands, except per share amounts)

	2010	2009	2008	2007 (2)	2006
Interest income	\$200,626	\$200,412	\$235,308	\$253,587	\$208,994
Interest expense	53,129	72,200	103,148	134,677	102,561
Net interest income	147,497	128,212	132,160	118,910	106,433
Provision for (recovery of) loan and lease losses	19,207	31,101	16,648	7,534	(2,736 )
Net interest income after provision for (recovery of) loan and lease losses	128,290	97,111	115,512	111,376	109,169
Noninterest income	86,691	85,530	84,003	70,619	76,585
Noninterest expense	154,505	151,123	153,114	140,312	126,211

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Income before income taxes	60,476	31,518	46,401	41,683	59,543
Income taxes	19,232	6,028	13,015	11,144	20,246
Net income	41,244	25,490	33,386	30,539	39,297
Net income available to common shareholders	\$29,655	\$19,074	\$33,386	\$30,539	\$39,297
Assets at year-end	\$4,445,281	\$4,542,100	\$4,464,174	\$4,447,104	\$3,807,315
Long-term debt and mandatorily redeemable securities at year-end	24,816	19,761	29,832	34,702	43,761
Shareholders' equity at year-end (3)	486,383	570,320	453,664	430,504	368,904
Basic net income per common share (1)	1.21	0.79	1.38	1.30	1.74
Diluted net income per common share (1)	1.21	0.79	1.37	1.28	1.72
Cash dividends per common share (1)	.610	.590	.580	.560	.534
Dividend payout ratio	50.41	% 74.68	% 42.34	% 43.75	% 31.05
Return on average assets	0.91	% 0.57	% 0.76	% 0.74	% 1.11
Return on average common equity	6.10	% 4.07	% 7.52	% 7.47	% 10.98
Average common equity to average assets	10.69	% 10.40	% 10.09	% 9.85	% 10.07

(1) The computation of per common share data gives retroactive recognition to a 10% stock dividend declared July 27, 2006.

(2) Results for 2007 and later include the acquisition of FINA Bancorp, Inc.

(3) Results for 2009 include the issuance of Preferred Stock under TARP. Refer to Note 13 of the Notes to Consolidated Financial Statements for further details.



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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The purpose of this analysis is to provide the reader with information relevant to understanding and assessing our results of operations for each of the past three years and financial condition for each of the past two years. In order to fully appreciate this analysis the reader is encouraged to review the consolidated financial statements and statistical data presented in this document.

Forward-Looking Statements

This report, including Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements. Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions, and future performance, and involve known and unknown risks, uncertainties and other factors, which may be beyond our control, and which may cause actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements.

All statements other than statements of historical fact are statements that could be forward-looking statements. Words such as "believe", "contemplate", "seek", "estimate", "plan", "project", "anticipate", "possible", "assume", "expect", "intend", "continue", "remain", "will", "should", "indicate", "would", "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Forward-looking statements provide current expectations or forecasts of future events and are not guarantees of future performance, nor should they be relied upon as representing management's views as of any subsequent date.

All written or oral forward-looking statements that are made by or attributable to us are expressly qualified in their entirety by this cautionary notice. We have no obligation and do not undertake to update, revise, or correct any of the forward-looking statements after the date of this report, or after the respective dates on which such statements otherwise are made. We have expressed our expectations, beliefs, and projections in good faith and we believe they have a reasonable basis. However, we make no assurances that our expectations, beliefs, or projections will be achieved or accomplished. These forward-looking statements may not be realized due to a variety of factors, including, without limitation, the following:

- Local, regional, national, and international economic conditions and the impact they may have on us and our clients and our assessment of that impact.
  - Changes in the level of nonperforming assets and charge-offs.
- Changes in estimates of future cash reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.
- The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board.
  - Inflation, interest rate, securities market, and monetary fluctuations.
    - Political instability.
    - Acts of war or terrorism.
  - Substantial increases in the cost of fuel.
- The timely development and acceptance of new products and services and perceived overall value of these products and services by others.
  - Changes in consumer spending, borrowings, and savings habits.
  - Changes in the financial performance and/or condition of our borrowers.
    - Technological changes.
    - Acquisitions and integration of acquired businesses.
  - The ability to increase market share and control expenses.

- Changes in the competitive environment among bank holding companies.
- The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities, and insurance) with which we and our subsidiaries must comply.
- The effect of changes in accounting policies and practices and auditing requirements, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, and other accounting standard setters.
  - Changes in our organization, compensation, and benefit plans.
- The costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews.
  - Greater than expected costs or difficulties related to the integration of new products and lines of business.
  - Our success at managing the risks described in Item 1A. Risk Factors.

#### Application of Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with U. S. generally accepted accounting principles (GAAP) and follow general practices within the industries in which we operate. Application of these principles requires our management to make estimates or judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates or judgments reflect our management's view of the most appropriate manner in which to record and report our overall financial performance. Because these estimates or judgments are based on current circumstances, they may change over time or prove to be inaccurate based on actual experience. As such, changes in these estimates, judgments, and/or assumptions may have a significant impact on our financial statements. All accounting policies are important, and all policies described in Part II, Item 8, Financial Statements and Supplementary Data, Note 1 (Note 1), should be reviewed for a greater understanding of how our financial performance is recorded and reported.

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We have identified three policies as being critical because they require our management to make particularly difficult, subjective, and/or complex estimates or judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the determination of the reserve for loan and lease losses, the valuation of mortgage servicing rights, and fair value measurements. Our management has used the best information available to make the estimations or judgments necessary to value the related assets and liabilities. Actual performance that differs from estimates or judgments and future changes in the key variables could change future valuations and impact net income. Our management has reviewed the application of these policies with the Audit Committee of the Board of Directors. Following is a discussion of the areas we view as our most critical accounting policies.

**Reserve for Loan and Lease Losses** — The reserve for loan and lease losses represents our management's estimate of probable losses inherent in the loan and lease portfolio and the establishment of a reserve that is sufficient to absorb those losses. In determining an adequate reserve, our management makes numerous judgments, assumptions, and estimates based on continuous review of the loan and lease portfolio, estimates of client performance, collateral values, and disposition, as well as historical loss rates and expected cash flows. In assessing these factors, our management benefits from a lengthy organizational history and experience with credit decisions and related outcomes. Nonetheless, if our management's underlying assumptions prove to be inaccurate, the reserve for loan and lease losses would have to be adjusted. Our accounting policy related to the reserve is disclosed in Note 1 under the heading "Reserve for Loan and Lease Losses."

**Fair Value Measurements** — We use fair value measurements to record certain financial instruments and to determine fair value disclosures. Available-for-sale securities, trading account securities, mortgage loans held for sale, and interest rate swap agreements are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial assets on a nonrecurring basis. These nonrecurring fair value adjustments typically involve write-downs of, or specific reserves against, individual assets. GAAP establishes a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used in the measurement are observable or unobservable. Observable inputs reflect market-driven or market-based information obtained from independent sources, while unobservable inputs reflect our estimates about market data.

The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market data. For financial instruments that trade actively and have quoted market prices or observable market data, there is minimal subjectivity involved in measuring fair value. When observable market prices and data are not fully available, management judgment is necessary to estimate fair value. In addition, changes in the market conditions may reduce the availability of quoted prices or observable data. For example, reduced liquidity in the capital markets or changes in secondary market activities could result in observable market inputs becoming unavailable. Therefore, when market data is not available, we use valuation techniques that require more management judgment to estimate the appropriate fair value measurement. Fair value is discussed further in Note 1 under the heading "Fair Value Measurements" and in Note 21, "Fair Values of Financial Instruments."

**Mortgage Servicing Rights Valuation** — We recognize as assets the rights to service mortgage loans for others, known as mortgage servicing rights, whether the servicing rights are acquired through purchases or through originated loans. Mortgage servicing rights do not trade in an active open market with readily observable market prices. Although sales of mortgage servicing rights do occur, the precise terms and conditions may not be readily available. As such, the value of mortgage servicing assets is established and valued using discounted cash flow modeling techniques which require management to make estimates regarding future net servicing cash flows, taking into consideration actual and expected mortgage loan prepayment rates, discount rates, servicing costs, and other economic factors. The expected rates of mortgage loan prepayments are the most significant factors driving the value of mortgage servicing assets.

Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced. In determining the fair value of the mortgage servicing assets, mortgage interest rates (which are used to determine prepayment rates), and discount rates are held constant over the estimated life of the portfolio. Expected mortgage loan prepayment rates are derived from a third-party model and adjusted to reflect our actual prepayment experience. Mortgage servicing assets are carried at the lower of amortized cost or fair value. The values of these assets are sensitive to changes in the assumptions used and readily available market pricing does not exist. The valuation of mortgage servicing assets is discussed further in Note 21 "Fair Values of Financial Instruments."

#### Earnings Summary

Net income in 2010 was \$41.24 million, up from \$25.49 million in 2009 and up from \$33.39 million in 2008. Diluted net income per common share was \$1.21 in 2010, \$0.79 in 2009, and \$1.37 in 2008. Return on average total assets was 0.91% in 2010 compared to 0.57% in 2009, and 0.76% in 2008. Return on average common shareholders' equity was 6.10% in 2010 versus 4.07% in 2009, and 7.52% in 2008.

Net income in 2010 was positively impacted by a \$19.29 million or 15.04% increase in net interest income and a \$11.89 million or 38.24% decrease in provision for loan and lease losses over 2009, which was offset by an increase of \$13.20 million or 219.04% in income tax expense. Net income in 2009, as compared to 2008, was negatively impacted by a \$14.45 million or 86.82% increase in provision for loan and lease losses over 2008 and a reduction of \$11.49 million gain due to sale of certain assets of Investment Advisors in 2008, which was offset by an improvement of \$11.68 million or 116.88% in investment securities due to impairment recorded in 2008 that was not present in 2009.

Dividends paid on common stock in 2010 amounted to \$0.61 per share, compared to \$0.59 per share in 2009, and \$0.58 per share in 2008. The level of earnings reinvested and dividend payouts are determined by the Board of Directors based on management's assessment of future growth opportunities and the level of capital necessary to support them.

**Net Interest Income** — Our primary source of earnings is net interest income, the difference between income on earning assets and the cost of funds supporting those assets. Significant categories of earning assets are loans and securities while deposits and borrowings represent the major portion of interest-bearing liabilities. For purposes of the following discussion, comparison of net interest income is done on a tax equivalent basis, which provides a common basis for comparing yields on earning assets exempt from federal income taxes to those which are fully taxable.

Net interest margin (the ratio of net interest income to average earning assets) is affected by movements in interest rates and changes in the mix of earning assets and the liabilities that fund those assets. Net interest margin on a fully taxable equivalent basis was 3.59% in 2010 compared to 3.14% in 2009, and 3.34% in 2008. The higher margin in 2010 reflects the decline in funding costs. Net interest income was \$147.50 million for 2010, compared to \$128.21 million for 2009. Tax-equivalent net interest income totaled \$150.87 million for 2010, an increase of \$18.87 million from the \$132.00 million reported for 2009. The \$18.87 million increase is mainly due to changes in rates.

During 2010, average earning assets increased \$7.97 million while average interest-bearing liabilities decreased \$39.72 million over the comparable period in 2009. The yield on average earning assets decreased 1 basis point to 4.85% for 2010 from 4.86% for 2009. Total cost of average interest-bearing liabilities decreased 54 basis points during 2010 as liabilities were impacted by decreases in market rates and rate repricing on maturing certificates of deposit. The result was an increase of 45 basis points to net interest spread, or the difference between interest income on earning assets and expense on interest-bearing liabilities.



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The largest contributor to the decrease in the yield on average earning assets in 2010 was the change in asset mix. Average net loans and leases decreased \$45.31 million or 1.44% in 2010 from 2009 while the yield increased 9 basis points to 5.53%. During 2010, the tax-equivalent yield on securities available for sale decreased 14 basis points to 3.14% while the average balance increased \$79.23 million. Average mortgages held for sale decreased \$22.08 million during 2010 and the yield decreased 61 basis points.

Average interest-bearing deposits decreased \$24.97 million during 2010 while the effective rate paid on those deposits decreased 59 basis points. Average noninterest-bearing demand deposits increased \$56.52 million during 2010.

Average short-term borrowings decreased \$21.46 million during 2010 while the effective rate paid decreased 11 basis points. Average long-term debt increased \$6.70 million during 2010 as the effective rate decreased 59 basis points.

The following table provides an analysis of net interest income and illustrates interest income earned and interest expense charged for each major component of interest earning assets and the interest bearing liabilities. Yields/rates are computed on a tax-equivalent basis, using a 35% rate. Nonaccrual loans and leases are included in the average loan and lease balance outstanding.

	2010			2009			2008		
	Average	Interest Income/ Expense	Yield/ Rate	Average	Interest Income/ Expense	Yield/ Rate	Average	Interest Income/ Expense	Yield/ Rate
(Dollars in thousands)	Balance			Balance			Balance		
<b>ASSETS</b>									
Investment securities:									
Taxable	\$ 743,838	\$ 20,466	2.75 %	\$ 629,229	\$ 17,594	2.80 %	\$ 491,061	\$ 22,170	4.51 %
Tax-exempt	170,415	8,201	4.81	205,796	9,801	4.76	222,751	10,692	4.80
Mortgages held for sale	52,097	2,430	4.66	74,173	3,907	5.27	33,925	2,069	6.10
Net loans and leases	3,109,508	171,843	5.53	3,154,820	171,669	5.44	3,263,276	202,539	6.21
Other investments	131,627	1,061	0.81	135,494	1,228	0.91	57,601	1,425	2.47
Total earning assets	4,207,485	204,001	4.85	4,199,512	204,199	4.86	4,068,614	238,895	5.87
Cash and due from banks	60,977			59,626			83,270		
Reserve for loan and lease losses	(89,656 )			(85,095 )			(71,358 )		
Other assets	364,896			331,809			319,997		
Total assets	\$ 4,543,702			\$ 4,505,852			\$ 4,400,523		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>									
Interest bearing deposits	\$ 3,121,167	\$ 44,605	1.43 %	\$ 3,146,135	\$ 63,521	2.02 %	\$ 2,996,830	\$ 86,903	2.90 %

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Short-term borrowings	164,191	800	0.49	185,647	1,115	0.60	386,850	7,626	1.97
Subordinated notes	89,692	6,589	7.35	89,692	6,589	7.35	90,960	6,714	7.38
Long-term debt and mandatorily redeemable securities	27,149	1,135	4.18	20,448	975	4.77	34,472	1,905	5.53
Total interest bearing liabilities	3,402,199	53,129	1.56	3,441,922	72,200	2.10	3,509,112	103,148	2.94
Noninterest bearing deposits	484,028			427,513			377,440		
Other liabilities	67,011			69,953			69,823		
Shareholders' equity	590,464			566,464			444,148		
Total liabilities and shareholders' equity	\$ 4,543,702			\$ 4,505,852			\$ 4,400,523		
Net interest income		\$ 150,872			\$ 131,999			\$ 135,747	
Net interest margin on a tax equivalent basis			3.59 %			3.14 %			3.34 %

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The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each. The following table shows changes in tax equivalent interest earned and interest paid, resulting from changes in volume and changes in rates:

(Dollars in thousands)	Increase (Decrease) due to		
	Volume	Rate	Net
2010 compared to 2009			
Interest earned on:			
Investment securities:			
Taxable	\$ 3,181	\$ (309 )	\$ 2,872
Tax-exempt	(1,704 )	104	(1,600 )
Mortgages held for sale	(1,063 )	(414 )	(1,477 )
Net loans and leases	(2,124 )	2,298	174
Other investments	(35 )	(132 )	(167 )
Total earning assets	\$ (1,745 )	\$ 1,547	\$ (198 )
Interest paid on:			
Interest bearing deposits	\$ (497 )	\$ (18,419 )	\$ (18,916 )
Short-term borrowings	(125 )	(190 )	(315 )
Subordinated notes	-	-	-
Long-term debt and mandatorily redeemable securities	257	(97 )	160
Total interest bearing liabilities	\$ (365 )	\$ (18,706 )	\$ (19,071 )
Net interest income	\$ (1,380 )	\$ 20,253	\$ 18,873
2009 compared to 2008			
Interest earned on:			
Investment securities:			
Taxable	\$ 12,787	\$ (17,363 )	\$ (4,576 )
Tax-exempt	(803 )	(88 )	(891 )
Mortgages held for sale	2,077	(239 )	1,838
Net loans and leases	(6,405 )	(24,465 )	(30,870 )
Other investments	(371 )	174	(197 )
Total earning assets	\$ 7,285	\$ (41,981 )	\$ (34,696 )
Interest paid on:			
Interest bearing deposits	\$ 4,560	\$ (27,942 )	\$ (23,382 )
Short-term borrowings	(2,787 )	(3,724 )	(6,511 )
Subordinated notes	(98 )	(27 )	(125 )
Long-term debt and mandatorily redeemable securities	(695 )	(235 )	(930 )
Total interest bearing liabilities	\$ 980	\$ (31,928 )	\$ (30,948 )
Net interest income	\$ 6,305	\$ (10,053 )	\$ (3,748 )



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Noninterest Income — Noninterest income increased \$1.16 million or 1.36% in 2010 from 2009 following a \$1.53 million or 1.82% increase in 2009 over 2008. Noninterest income for the most recent three years ended December 31 was as follows:

(Dollars in thousands)	2010	2009	2008
Noninterest income:			
Trust fees	\$ 15,838	\$ 15,036	\$ 18,599
Service charges on deposit accounts	19,323	20,645	22,035
Mortgage banking income	6,218	8,251	2,994
Insurance commissions	5,074	4,930	5,363
Equipment rental income	26,036	25,757	24,224
Other income	11,909	9,224	9,293
Gain on sale of certain Investment Advisor assets	-	-	11,492
Investment securities and other investment gains (losses)	2,293	1,687	(9,997)
Total noninterest income	\$ 86,691	\$ 85,530	\$ 84,003

Trust fees (which include investment management fees, estate administration fees, mutual fund fees, annuity fees, and fiduciary fees) increased by \$0.80 million or 5.33% in 2010 from 2009 compared to a decrease of \$3.56 million or 19.16% in 2009 over 2008. Trust fees are largely based on the size of client relationships and the market value of assets under management. The market value of trust assets under management at December 31, 2010 and 2009 was \$3.19 billion and \$2.80 billion, respectively. At December 31, 2010, these trust assets were comprised of \$1.92 billion of personal and agency trusts, \$879.32 million of employee benefit plan assets, \$303.44 million of estate administration assets and individual retirement accounts, and \$84.90 million of custody assets. The increase in trust fees in 2010 was a result of an increase in the market values of investment accounts. The decline in trust fees in 2010 and 2009 from 2008 was primarily due to a reduction in our investment advisory management fees received from the 1st Source Monogram Funds due to the sale of assets related to the management of such funds in December 2008. The reduction in investment advisory management fees was partially offset by earnout fees on the sale of \$3.06 million in 2010 and \$2.10 million in 2009 which were reflected in other income.

Service charges on deposit accounts decreased \$1.32 million or 6.40% in 2010 from 2009 compared to a decrease of \$1.39 million or 6.31% in 2009 from 2008. The decline in service charges on deposit accounts in 2010 reflects a lower volume of nonsufficient fund transactions. The decline in service charges on deposit accounts in 2009 reflects a lower volume of overdraft and nonsufficient fund transactions.

Mortgage banking income decreased \$2.03 million or 24.64% in 2010 over 2009, compared to an increase of \$5.26 million or 175.58% in 2009 over 2008. In 2010, we had no valuation adjustments of mortgage servicing rights compared to \$2.07 million in recoveries of mortgage servicing rights impairment in 2009. In 2009, we also had increased gains on sale of loans over 2008 levels. During 2010, 2009 and 2008, we determined that no permanent write-down was necessary for previously recorded impairment on mortgage servicing assets.

Insurance commissions were relatively flat in 2010 from 2009 compared to a decrease of \$0.43 million or 8.07% in 2009 from 2008. The lower commission income in 2009 was mainly due to lower premiums as a result of market conditions and a reduction in customer accounts.

Equipment rental income generated from operating leases grew by \$0.28 million or 1.08% during 2010 from 2009 compared to an increase of \$1.53 million or 6.33% during 2009 from 2008. Revenues from operating leases for transportation equipment, aircraft and special purpose vehicles increased as clients responded positively to our marketing efforts and entered into new lease agreements.

On August 25, 2008, Investment Advisors entered into a Purchase and Sale Agreement with WA Holdings, Inc. ("Buyer") whereby Investment Advisors agreed to sell certain assets to Buyer and to enter into a long-term strategic partnership with Buyer. Pursuant to the Purchase and Sale Agreement, in December 2008, Buyer and its wholly-owned subsidiary, Wasatch Advisors, Inc., investment advisor of the Wasatch Funds, Inc., acquired assets of Investment Advisors related to the management of the 1st Source Monogram Mutual Funds - the Income Equity Fund, the Long/Short Fund and the Income Fund. The 1st Source Monogram Mutual Funds were reorganized into the Wasatch - 1st Source Income Equity Fund, the Wasatch - 1st Source Long/Short Fund, and the Wasatch - 1st Source Income Fund. Investment Advisors recorded a net gain of \$11.49 million at closing, which was net of \$1.51 million of legal and compensation expense.

Investment securities and other investment gains totaled \$2.29 million for the year ended 2010 compared to gains of \$1.69 million for the year ended 2009 and losses of \$10.00 million for the year ended 2008. In 2008, we took \$10.82 million in impairment charges on investments in the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) preferred stock and other preferred equities as a result of the deterioration in the residential mortgage business and government intervention at the FNMA and the FHLMC. Due to the uncertainty of future market conditions and how they might impact the financial performance of the FNMA and the FHLMC, we sold our remaining shares of the FHLMC and FNMA preferred stock in 2009 realizing gains of \$390 thousand. Also due to market uncertainty in 2009, we sold our remaining shares of corporate preferred stocks, realizing losses of \$688 thousand. In 2010, we recognized a gain on sale of a venture capital investment of \$1.62 million and had other partnership gains of \$0.64 million.

Other income increased \$2.69 million or 29.11% in 2010 from 2009 and remained relatively stable in 2009 from 2008. The increase in other income in 2010 was primarily due to higher bank owned life insurance income and higher earnout fees on the Wasatch sale.

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Noninterest Expense — Noninterest expense increased \$3.38 million or 2.24% in 2010 over 2009 following a \$1.99 million or 1.30% decrease in 2009 from 2008. Noninterest expense for the recent three years ended December 31 was as follows:

(Dollars in thousands)	2010	2009	2008
Noninterest expense:			
Salaries and employee benefits	\$ 75,815	\$ 72,483	\$ 76,965
Net occupancy expense	8,788	9,185	9,698
Furniture and equipment expense	12,543	13,980	15,095
Depreciation — leased equipment	20,715	20,515	19,450
Professional fees	6,353	4,399	8,446
Supplies and communications	5,499	5,916	6,782
Business development and marketing expense	3,774	3,488	3,749
Loan and lease collection and repossession expense	6,227	4,283	1,162
FDIC and other insurance	6,256	8,362	2,601
Intangible asset amortization	1,324	1,352	1,393
Other expense	7,211	7,160	7,773
Total noninterest expense	\$ 154,505	\$ 151,123	\$ 153,114

Total salaries and employee benefits increased \$3.33 million or 4.60% in 2010 from 2009, following a \$4.48 million or 5.82% decrease in 2009 from 2008.

Employee salaries increased \$1.34 million or 2.19% in 2010 from 2009 compared to a decrease of \$0.63 million or 1.02% in 2009 from 2008. The increase in 2010 was primarily due to higher executive incentive expense offset by lower base salaries. The decline in 2009 was the result of a reduced work force offset by a decline in salaries deferred relating to the origination of loans.

Employee benefits grew by \$1.99 million or 17.75% in 2010 from 2009, compared to a decrease of \$3.85 million or 25.56% in 2009 from 2008. The increase in 2010 was primarily due to higher group insurance costs and a one-time reversal of post retirement benefit obligations in 2009 due to the termination of the post retirement benefit plan for new retirees which was not present in 2010. The decrease in 2009 was primarily due to lower group insurance costs and a one-time reversal of post retirement benefit obligations due to the termination of the post retirement benefit plan for new retirees.

Occupancy expense decreased \$0.40 million or 4.32% in 2010 from 2009, compared to a decrease of \$0.51 million or 5.29% in 2009 from 2008. The decrease in 2010 was mainly a result of lower real estate taxes offset by higher repair costs on our premises. The decrease in 2009 was mainly due to lower repair costs on our premises.

Furniture and equipment expense, including depreciation, declined \$1.44 million or 10.28% in 2010 from 2009 compared to a decline of \$1.12 million or 7.39% in 2009 from 2008. The decrease in 2010 was caused by lower depreciation expense, computer processing charges and ATM operating expense. The decrease in 2009 was caused by lower depreciation expense and lower computer processing charges.

Depreciation on equipment owned under operating leases increased \$0.20 million or 0.97% in 2010 from 2009, following a \$1.07 million or 5.48% increase in 2009 from 2008. In 2010 and 2009, depreciation on equipment owned under operating leases increased in conjunction with the increase in equipment rental income as some of our clients opted to enter into new lease arrangements rather than purchase equipment.

Professional fees increased \$1.95 million or 44.42% in 2010 from 2009, compared to a \$4.05 million or 47.92% decrease in 2009 from 2008. In 2008, professional fees were higher due to expenses recorded for a systems security breach that occurred in May 2008 and other consulting expenses. In 2009, professional fees returned to the 2007 level. In 2010, professional fees were higher than 2009 levels due to deposit pricing modeling and strategic planning consulting costs.

Supplies and communications expense decreased \$0.42 million or 7.05% in 2010 from 2009 after a \$0.87 million or 12.77% decrease in 2009 as compared to 2008. The decreases in 2010 and 2009 were primarily a result of lower postage expense and printing and supplies expense.

Business development and marketing expense increased \$0.29 million or 8.20% in 2010 from 2009 compared to a \$0.26 million or 6.96% decrease in 2009 from 2008. The higher costs in 2010 were in the areas of retail marketing and mutual fund rebates. The decrease in 2009 was related to lower retail marketing and institutional marketing expenses.

Loan and lease collection and repossession expenses increased \$1.94 million or 45.39% in 2010 from 2009 compared to an increase of \$3.12 million or 268.59% in 2009 from 2008. The higher expenses in 2010 mainly resulted from valuation adjustments on aircraft repossessions and mortgage loan repurchase losses. The increase in 2009 was due to increased collection and repossession activity as our nonperforming assets increased.

FDIC and other insurance expense declined \$2.11 million or 25.19% in 2010 over 2009 versus a \$5.76 million or 221.49% increase in 2009 over 2008. The 2010 reduction in Federal Deposit Insurance Corporation (FDIC) insurance premiums resulted from lack of the special insurance assessment incurred in 2009. The increase in 2009 was due to higher FDIC insurance premiums as insurance rates increased and a \$1.98 million special FDIC insurance assessment which was calculated at 5 basis points of assets minus tier 1 capital as of June 30, 2009.

Intangible asset amortization decreased \$0.03 million or 2.07% in 2010 from 2009 compared to a \$0.04 million or 2.94% decrease in 2009 from 2008. The decreases in 2010 and 2009 were due to carrying value adjustments relating to a prior acquisition.

Other expenses were flat in 2010 as compared to 2009 following a decrease of \$0.61 million or 7.89% in 2009 from 2008. The decrease in 2009 was due to higher deferred costs on originated loans, lower convention costs, lower trust preferred amortization expense and lower filing expenses offset by higher mortgage loan payoff expense and lower gain on sale of operating equipment.

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Income Taxes — 1st Source recognized income tax expense in 2010 of \$19.23 million, compared to \$6.03 million in 2009, and \$13.02 million in 2008. The effective tax rate in 2010 was 31.80% compared to 19.13% in 2009, and 28.05% in 2008. The effective tax rate was lower in 2009 compared to 2010 and 2008 due to a one time benefit of \$2.60 million and an increase in tax-exempt interest in relation to income before taxes. The 2009 benefit was the result of a reduction in our tax contingency reserve due to the resolution of tax audits. For a detailed analysis of 1st Source's income taxes see Part II, Item 8, Financial Statements and Supplementary Data — Note 17 of the Notes to Consolidated Financial Statements.

## Financial Condition

Loan and Lease Portfolio — The following table shows 1st Source's loan and lease distribution at the end of each of the last five years as of December 31:

(Dollars in thousands)	2010	2009	2008	2007	2006
Commercial and agricultural loans	\$530,228	\$546,222	\$643,440	\$593,806	\$478,310
Auto, light truck and environmental equipment	396,500	349,741	353,838	305,238	317,604
Medium and heavy duty truck	162,824	204,545	243,375	300,469	341,744
Aircraft financing	614,357	617,384	632,121	587,022	498,914
Construction equipment financing	285,634	313,300	375,983	377,785	305,976
Commercial real estate	594,729	580,709	574,394	530,448	412,523
Residential real estate	390,951	371,514	344,355	351,198	219,760
Consumer loans	95,400	109,735	130,706	145,475	127,706
Total loans and leases	\$3,070,623	\$3,093,150	\$3,298,212	\$3,191,441	\$2,702,537

At December 31, 2010, 11.6% of total loans and leases were concentrated with auto rental and leasing and 10.9% of total loans and leases were concentrated with construction end users.

Average loans and leases, net of unearned discount, decreased \$45.31 million or 1.44% and decreased \$108.46 million or 3.32% in 2010 and 2009, respectively. Loans and leases, net of unearned discount, at December 31, 2010, were \$3.07 billion and were 69.08% of total assets, compared to \$3.09 billion and 68.10% of total assets at December 31, 2009.

Commercial and agricultural lending, excluding those loans secured by real estate, decreased \$15.99 million or 2.93% in 2010 over 2009. Commercial and agricultural lending outstandings were \$530.23 million and \$546.22 million at December 31, 2010 and December 31, 2009, respectively. This decrease was mainly due to the weak economy in our geographic markets. Businesses reduced their working capital line of credit borrowings given lower accounts receivable and inventory levels caused by a decline in their sales. The weak economy also accounted for a reduction in term loan financing attributed to less equipment purchases by companies in our market.

Auto, light truck, and environmental equipment financing increased \$46.76 million or 13.37% in 2010 over 2009. At December 31, 2010, auto, light truck, and environmental equipment financing had outstandings of \$396.50 million and \$349.74 million at December 31, 2009. The increase was mainly due to significant growth in the auto rental and leasing segments. These segments were abandoned by other lenders during the credit crisis and we have been able to develop new accounts. In addition, our current clients asked for expanded credit limits and utilized them fully.

Medium and heavy duty truck loans and leases decreased \$41.72 million or 20.40% in 2010. Medium and heavy duty truck financing at December 31, 2010 and 2009 had outstandings of \$162.82 million and \$204.55 million, respectively. Most of the decrease at December 31, 2010 from December 31, 2009 can be attributed to a reduced need

for funding as over-capacity issues caused our customer base to downsize their fleets.

Aircraft financing at year-end 2010 decreased only slightly by \$3.03 million or 0.49% from year-end 2009. Aircraft financing at December 31, 2010 and 2009 had outstandings of \$614.36 million and \$617.38 million, respectively.

Construction equipment financing decreased \$27.67 million or 8.83% in 2010 compared to 2009. Construction equipment financing at December 31, 2010 had outstandings of \$285.63 million, compared to outstandings of \$313.30 million at December 31, 2009. The decrease in this category was primarily due to a national decrease in construction related activity and a decrease in sales of both new and used construction equipment.

Commercial loans secured by real estate, the majority of which is owner occupied, increased \$14.02 million or 2.41% during 2010 over 2009. Commercial loans secured by real estate outstanding at December 31, 2010 were \$594.73 million and \$580.71 million at December 31, 2009.

Residential real estate loans were \$390.95 million at December 31, 2010 and \$371.51 million at December 31, 2009. Residential real estate loans increased \$19.44 million or 5.23% in 2010 from 2009. The increase in residential mortgage lending was primarily due to a higher volume of refinance activity as a result of lower market interest rates and our decision to retain more loans in our portfolio.

Consumer loans decreased \$14.34 million or 13.06% in 2010 over 2009. Consumer loans outstanding at December 31, 2010, were \$95.40 million and \$109.74 million at December 31, 2009. The decrease during 2010 was due to higher unemployment rates in our primary markets, thereby decreasing the demand for consumer loans.

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The following table shows the maturities of loans and leases in the categories of commercial and agriculture, auto, light truck and environmental equipment, medium and heavy duty truck, aircraft and construction equipment outstanding as of December 31, 2010. The amounts due after one year are also classified according to the sensitivity to changes in interest rates.

(Dollars in thousands)	0-1 Year	1-5 Years	Over 5 Years	Total
Commercial and agricultural loans	\$319,274	\$203,476	\$7,478	\$530,228
Auto, light truck and environmental equipment	187,415	207,800	1,285	396,500
Medium and heavy duty truck	64,563	97,027	1,234	162,824
Aircraft financing	201,399	337,568	75,390	614,357
Construction equipment financing	107,192	177,606	836	285,634
Total	\$879,843	\$1,023,477	\$86,223	\$1,989,543

Rate Sensitivity (Dollars in thousands)	Fixed Rate	Variable Rate	Total
1 – 5 Years	\$ 555,463	\$ 468,014	\$ 1,023,477
Over 5 Years	2,555	83,668	86,223
Total	\$ 558,018	\$ 551,682	\$ 1,109,700

Most of the Bank's residential mortgages are sold into the secondary market. Mortgage loans held for sale were \$32.60 million at December 31, 2010 and were \$26.65 million at December 31, 2009. Although 1st Source Bank is participating in the U.S. Treasury Making Home Affordable programs, we do not feel it has a material effect on our financial condition or results of operations.

1st Source Bank sells residential mortgage loans to Fannie Mae and Freddie Mac, as well as FHA-insured and VA-guaranteed loans in Ginnie Mae mortgage-backed securities. Additionally, we have sold loans on a service released basis to various other financial institutions in recent years. The agreements under which we sell these mortgage loans contain various representations and warranties regarding the acceptability of loans for purchase. On occasion, we may be asked to indemnify the loan purchaser for credit losses on loans that were later deemed ineligible for purchase or we may be asked to repurchase a loan. Both circumstances are collectively referred to as "repurchases". Within the industry, repurchase demands have increased during 2010. While we believe the quality of loans we have underwritten and sold to these entities has been superior, we must acknowledge the current trend of mortgage insurance rescissions and speculative repurchase requests.

Our liability for repurchases, included in accrued expenses and other liabilities on the Statement of Financial Condition, was \$0.74 million and \$0.38 million as of December 31, 2010 and 2009, respectively. The mortgage repurchase liability represents our best estimate of the loss that we may incur. The estimate is based on specific loan repurchase requests and a historical loss ratio with respect to origination dollar volume. Because the level of mortgage loan repurchase losses are dependent on economic factors, investor demand strategies and other external conditions that may change over the life of the underlying loans, the level of liability for mortgage loan repurchase losses is difficult to estimate and requires considerable management judgment.

In 2010, we made the decision to end our relationships with nine mortgage brokerage firms and ceased our wholesale residential mortgage lending operation. We exited wholesale mortgage lending due to the increasing compliance risks, limited success in developing deeper relationships with customers whose mortgages were not originated by us, and lack of synergies in our footprint where independent mortgage brokers competed directly with our own team of mortgage originators. We will continue to offer consumer mortgage products by increasing the number of mortgage originators employed directly by us. Thus, we do not anticipate that our decision to discontinue wholesale mortgage

lending will have a material effect on our financial performance over the long term.

#### Credit Experience

**Reserve for Loan and Lease Losses** — Our reserve for loan and lease losses is provided for by direct charges to operations. Losses on loans and leases are charged against the reserve and likewise, recoveries during the period for prior losses are credited to the reserve. Our management evaluates the adequacy of the reserve quarterly, reviewing all loans and leases over a fixed-dollar amount (\$100,000) where the internal credit rating is at or below a predetermined classification, actual and anticipated loss experience, current economic events in specific industries, and other pertinent factors including general economic conditions. Determination of the reserve is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows or fair value of collateral on collateral-dependent impaired loans and leases, estimated losses on pools of homogeneous loans and leases based on historical loss experience, and consideration of environmental factors, principally economic risk and concentration risk, all of which may be susceptible to significant and unforeseen changes. We review the status of the loan and lease portfolio to identify borrowers that might develop financial problems in order to aid borrowers in the handling of their accounts and to mitigate losses. See Part II, Item 8, Financial Statements and Supplementary Data — Note 1 of the Notes to Consolidated Financial Statements for additional information on management's evaluation of the adequacy of the reserve for loan and lease losses.

The reserve for loan and lease loss methodology has been consistently applied for several years, with enhancements instituted periodically. Reserve ratios are reviewed quarterly and revised periodically to reflect recent loss history and to incorporate current risks and trends which may not be recognized in historical data. As we update our historical charge-off analysis, we review the look-back periods for each business loan portfolio. We changed the short period portion of the look-back to two years given that 2010 and 2009 losses were considerably impacted by the severe recession which began in December 2007, but whose financial consequences were not recognized in the loan portfolios until 2009. We gave the greatest weight to this recent two year period in our calculation, as we feel it is most consistent with our current expectations for 2011. Furthermore, we perform a thorough analysis of charge-offs, non-performing asset levels, special attention outstandings and delinquency in order to review portfolio trends and other factors, including specific industry risks and economic conditions, which may have an impact on the reserves and reserve ratios applied to various portfolios. We adjust the calculated historical based ratio as a result of our analysis of environmental factors, principally economic risk and concentration risk. Key economic factors affecting our portfolios are growth in gross domestic product, unemployment rates, housing market trends, commodity prices and inflation. Concentration risk is impacted primarily by geographic concentration in Northern Indiana and Southwestern Lower Michigan in our business banking and commercial real estate portfolios and by collateral concentration in our specialty finance portfolios.



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During 2010, we sustained large losses on two significant commercial real estate projects as well as numerous smaller losses on several real estate related transactions, many of which were owner occupied facilities where there was doubt as to the ability of the underlying business operations capacity to continue to perform. While our commercial real estate loss ratio remains significantly below our peer group, our recent loss history indicated an increase in the reserve ratio for this portfolio was necessary and prudent.

A second area of concern as we move into 2011 is our aircraft portfolio. Several aircraft borrowers who are experiencing financial difficulty have significant commercial real estate exposure. The severe recession and the protracted recovery have had a negative effect on our borrowers and global economic concerns have resulted in plummeting aircraft values. As a result of current economic conditions and the depressed private jet market as evidenced by significant declines in new jet deliveries and continuous softening of used jet prices, we have increased our reserves for the aircraft portfolio.

The medium and heavy duty truck portfolio was another portfolio where we experienced relatively large losses in 2010. We recognized sizable losses on five relationships during the first six months of the year; however, there were no charge-offs during the second half of the year. Current industry concerns are focused on capacity constraints resulting from potential new safety and environmental regulations and driver shortages. Nevertheless, the underlying fundamentals appear to be improving. As a result, we lowered our calculated reserve ratio slightly as a result of lower environmental risk.

For 2010, construction equipment losses as a percentage of average loans were lower than losses for commercial real estate, aircraft and trucking, but were still significantly greater than the two year and ten year portfolio average, and continued throughout the year, indicating high potential for losses in 2011 in this portfolio. The private sector construction industry remains depressed. Losses have been mitigated by relatively strong collateral values due to the global market for used construction equipment. We increased our calculated reserve slightly for this portfolio.

The auto, light truck and environmental equipment portfolio has been a source of strength during this time of economic turmoil. Portfolio credit quality remained exceptionally strong, with low delinquencies and net charge-offs. Industry dynamics have changed favorably for franchisees with stable to increasing rental rates, strong used car prices and improved efficiencies in the business model with downsized fleets and fewer repurchase vehicles. The reserve ratio was not revised.

There are several industries represented in the commercial and agricultural portfolio. The outlook for the business banking portfolio is somewhat mixed. While recent economic news indicates improvement, the economy remains weak and there is a lack of confidence among small business owners. With the struggling job market, unemployment remains high, which also bodes poorly for our residential real estate and consumer portfolios. The outlook for the agriculture portfolio is strong, with increasing crop prices and land values. Agricultural input costs are higher, but the strong commodity prices are more than offsetting the increased input costs. We have reviewed the calculated loss ratios and the environmental factors and concentration issues affecting these portfolios and incorporated minor adjustments to the reserve ratios as deemed appropriate.

The reserve for loan and lease losses at December 31, 2010, totaled \$86.87 million and was 2.83% of loans and leases, compared to \$88.24 million or 2.85% of loans and leases at December 31, 2009 and \$79.78 million or 2.42% of loans and leases at December 31, 2008. It is our opinion that the reserve for loan and lease losses was adequate to absorb losses inherent in the loan and lease portfolio as of December 31, 2010.

Charge-offs for loan and lease losses were \$24.11 million for 2010, compared to \$28.22 million for 2009 and \$8.39 million for 2008. Charge-offs decreased in 2010 due to a decrease in nonperforming loans and leases reflecting a slowly improving economy. In 2010, the ten largest charge-offs accounted for fifty percent of total losses. The large

losses were principally attributable to loans secured by aircraft or commercial real estate as a result of the decline in the values of the underlying collateral. Charge-offs increased in 2009 compared to 2008 as a result of an increase in nonperforming loans and leases related to weaker economic conditions. The provision for loan and lease losses was \$19.21 million for 2010, compared to the provision for loan and lease losses of \$31.10 million for 2009 and the provision for loan and lease losses of \$16.65 million for 2008. The high provision for loan and lease losses in 2010 and 2009 was due to the deterioration in the loan portfolio mainly due to the deterioration in the economy which led to a decline in underlying collateral values.

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The following table summarizes our loan and lease loss experience for each of the last five years ended December 31:

(Dollars in thousands)	2010	2009	2008	2007	2006
Amounts of loans and leases outstanding at end of period	\$3,070,623	\$3,093,150	\$3,298,212	\$3,191,441	\$2,702,537
Average amount of net loans and leases outstanding					