



BNCCORP

Quarterly Report

For the quarter ended June 30, 2011

BNCCORP, INC.

(OTC Markets:BNCC)

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BNCCORP, INC.
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June 30, 2011

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FINANCIAL INFORMATION

Item 1. Financial Statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets
(In thousands, except share data)

ASSETS	June 30, 2011 (unaudited)	December 31, 2010
CASH AND CASH EQUIVALENTS	\$ 26,379	\$ 112,847
INVESTMENT SECURITIES AVAILABLE FOR SALE	220,498	137,032
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	2,697	2,862
LOANS HELD FOR SALE-MORTGAGE BANKING	30,269	29,116
PARTICIPATING INTERESTS IN MORTGAGE LOANS	609	4,888
LOANS AND LEASES HELD FOR INVESTMENT	312,473	350,501
ALLOWANCE FOR CREDIT LOSSES	(11,045)	(14,765)
Net loans and leases held for investment	302,037	340,624
OTHER LOANS HELD FOR SALE, net	-	70,501
OTHER REAL ESTATE, net	13,952	12,706
PREMISES AND EQUIPMENT, net	16,313	16,684
INTEREST RECEIVABLE	2,236	2,138
OTHER ASSETS	18,652	19,790
PREMISES AND EQUIPMENT HELD FOR SALE, net	-	2,769
Total assets	<u>\$ 633,033</u>	<u>\$ 747,069</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	\$ 92,538	\$ 91,478
Interest-bearing –		
Savings, interest checking and money market	250,489	243,332
Time deposits \$100,000 and over	70,185	83,490
Time deposits under \$100,000	136,093	135,365
	<u>549,305</u>	<u>553,665</u>
Non-interest-bearing held for sale	-	34,610
Interest-bearing held for sale	-	72,836
Total deposits	<u>549,305</u>	<u>661,111</u>
SHORT-TERM BORROWINGS	13,852	16,329
FEDERAL HOME LOAN BANK ADVANCES	-	-
OTHER BORROWINGS	-	-
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	22,426	22,425
ACCRUED INTEREST PAYABLE	3,187	2,561
ACCRUED EXPENSES	4,635	4,704
OTHER LIABILITIES	2,349	2,618
Total liabilities	<u>595,754</u>	<u>709,748</u>
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.01 par value – Authorized 2,000,000 shares:		
Preferred stock - 5% Series A 20,093 shares outstanding;	19,523	19,411
Preferred stock - 9% Series B 1,005 shares outstanding;	1,064	1,075
Common stock, \$.01 par value – Authorized 35,000,000 shares; 3,302,926 and 3,304,339 shares issued and outstanding	33	33
Capital surplus – common stock	27,128	27,036
Retained earnings (deficit)	(6,784)	(7,322)
Treasury stock (365,727 and 364,314 shares, respectively)	(5,072)	(5,069)
Accumulated other comprehensive gain, net	1,387	2,157
Total stockholders' equity	<u>37,279</u>	<u>37,321</u>
Total liabilities and stockholders' equity	<u>\$ 633,033</u>	<u>\$ 747,069</u>

See accompanying notes to consolidated financial statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Operations
(In thousands, except per share data, unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
INTEREST INCOME:				
Interest and fees on loans	\$ 4,106	\$ 6,099	\$ 9,166	\$ 12,632
Interest and dividends on investments				
Taxable	2,090	2,297	3,878	5,002
Tax-exempt	25	23	48	46
Dividends	35	32	71	60
Total interest income	<u>6,256</u>	<u>8,451</u>	<u>13,163</u>	<u>17,740</u>
INTEREST EXPENSE:				
Deposits	1,192	2,305	2,572	4,841
Short-term borrowings	34	15	69	31
Federal Home Loan Bank advances	-	-	-	113
Long-term borrowings	-	-	-	-
Subordinated debentures	334	318	666	604
Total interest expense	<u>1,560</u>	<u>2,638</u>	<u>3,307</u>	<u>5,589</u>
Net interest income	<u>4,696</u>	<u>5,813</u>	<u>9,856</u>	<u>12,151</u>
PROVISION FOR CREDIT LOSSES	<u>500</u>	<u>1,500</u>	<u>1,100</u>	<u>3,500</u>
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	<u>4,196</u>	<u>4,313</u>	<u>8,756</u>	<u>8,651</u>
NON-INTEREST INCOME:				
Bank charges and service fees	573	582	1,133	1,199
Wealth management revenues	332	590	717	1,161
Mortgage banking revenues	2,287	2,829	4,350	5,014
Gains on sales of loans, net	412	-	900	-
Gains on sales of securities, net	835	1,368	1,196	3,873
Other	278	191	457	599
Total non-interest income	<u>4,717</u>	<u>5,560</u>	<u>8,753</u>	<u>11,846</u>
NON-INTEREST EXPENSE:				
Salaries and employee benefits	3,655	3,893	7,668	7,993
Professional services	1,100	1,353	1,837	2,118
Data processing fees	696	666	1,381	1,268
Occupancy	480	697	1,066	1,428
Regulatory costs	476	443	992	828
Marketing and promotion	406	344	720	674
Other real estate costs	356	278	677	732
Depreciation and amortization	295	322	592	653
Office supplies and postage	137	156	282	306
Fraud loss on assets serviced by others	-	26,231	-	26,231
Other	661	591	1,070	1,225
Total non-interest expense	<u>8,262</u>	<u>34,974</u>	<u>16,285</u>	<u>43,456</u>
Income (loss) before income taxes	651	(25,101)	1,224	(22,959)
Income tax expense	2	120	2	72
NET INCOME (LOSS)	<u>649</u>	<u>(25,221)</u>	<u>1,222</u>	<u>(23,031)</u>
Preferred stock costs	(345)	(331)	(684)	(655)
Net income (loss) available to common shareholders	<u>\$ 304</u>	<u>\$ (25,552)</u>	<u>\$ 538</u>	<u>\$ (23,686)</u>
Basic earnings (loss) per common share	<u>\$ 0.09</u>	<u>\$ (7.79)</u>	<u>\$ 0.16</u>	<u>\$ (7.22)</u>
Diluted earnings (loss) per common share	<u>\$ 0.09</u>	<u>\$ (7.79)</u>	<u>\$ 0.16</u>	<u>\$ (7.22)</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(In thousands, unaudited)

	For the Three Months		For the Six Months	
	Ended June 30,		Ended June 30,	
	2011	2010	2011	2010
NET INCOME (LOSS)	\$ 649	\$ (25,221)	\$ 1,222	\$(23,031)
Amortization of deferred gain in other comprehensive income	\$ -	\$ -	\$ -	\$ (40)
Unrealized gain on securities available for sale	2,308	810	426	7,426
Reclassification adjustment for (gain) included in net income	<u>(835)</u>	<u>(1,368)</u>	<u>(1,196)</u>	<u>(3,873)</u>
Other comprehensive income (loss), before tax	1,473	(558)	(770)	3,513
Income tax expense related to items of other comprehensive income (loss)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Other comprehensive income (loss)	<u>1,473</u>	<u>(558)</u>	<u>(770)</u>	<u>3,513</u>
TOTAL COMPREHENSIVE INCOME (LOSS)	<u><u>\$2,122</u></u>	<u><u>\$ (25,779)</u></u>	<u><u>\$ 452</u></u>	<u><u>\$(19,518)</u></u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the Six Months Ended June 30,
(In thousands, except share data, unaudited)

	Preferred Stock		Common Stock		Capital	Retained	Treasury	Accumulated	Total
	Shares	Amount	Shares	Amount	Surplus Common Stock	Earnings (Deficit)	Stock	Other Comprehensive Income (Loss)	
BALANCE, December 31, 2009	21,098	\$ 20,285	3,290,219	\$ 33	\$ 26,885	\$ 16,078	\$ (5,068)	\$ (948)	\$ 57,265
Net loss	-	-	-	-	-	(23,031)	-	-	(23,031)
Other comprehensive gain	-	-	-	-	-	-	-	3,513	3,513
Preferred stock amortization, net	-	101	-	-	-	(101)	-	-	-
Accrued dividend on preferred stock	-	-	-	-	-	(554)	-	-	(554)
Impact of share-based compensation	-	-	5,000	-	57	-	-	-	57
BALANCE, June 30, 2010	21,098	\$ 20,386	3,295,219	\$ 33	\$ 26,942	\$ (7,608)	\$ (5,068)	\$ 2,565	\$ 37,250
BALANCE, December 31, 2010	21,098	\$ 20,486	3,304,339	\$ 33	\$ 27,036	\$ (7,322)	\$ (5,069)	\$ 2,157	\$ 37,321
Net income	-	-	-	-	-	1,222	-	-	1,222
Other comprehensive loss	-	-	-	-	-	-	-	(770)	(770)
Preferred stock amortization, net	-	101	-	-	-	(101)	-	-	-
Accrued dividend on preferred stock	-	-	-	-	-	(583)	-	-	(583)
Impact of share-based compensation	-	-	(1,413)	-	92	-	(3)	-	89
BALANCE, June 30, 2011	21,098	\$ 20,587	3,302,926	\$ 33	\$ 27,128	\$ (6,784)	\$ (5,072)	\$ 1,387	\$ 37,279

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the Six Months Ended June 30,

(In thousands, unaudited)

	<u>2011</u>	<u>2010</u>
OPERATING ACTIVITIES:		
Net income (loss)	\$ 1,222	\$ (23,031)
Adjustments to reconcile net income (loss) to net cash provided by operating activities -		
Provision for credit losses	1,100	3,500
Provision for other real estate losses	400	634
Depreciation and amortization	592	653
Net amortization of premiums and (discounts) on investment securities and subordinated debentures	870	(444)
Share-based compensation	92	57
Change in interest receivable and other assets, net	748	2,964
Fraud loss on assets serviced by others	-	26,231
(Gain) loss on sale of other real estate	(50)	155
Bank premises and equipment, net charges associated with branch closure	-	101
Gain on sale of bank premises and equipment	(11)	-
Gain on sale of branch	-	(403)
Net realized gain on sales of investment securities	(1,196)	(3,873)
Provision for deferred income taxes	-	(48)
Change in other liabilities, net	(3)	3,714
Funding of originations of loans held for sale	(241,136)	(216,034)
Proceeds from sales of loans held for sale	240,620	213,164
Fair value adjustment for loans held for sale	(636)	(741)
Proceeds from sales of loans	8,419	-
Gains on sales of loans, net	(900)	-
Net cash provided by operating activities	<u>10,131</u>	<u>6,599</u>
INVESTING ACTIVITIES:		
Purchases of investment securities	(169,227)	(21,328)
Proceeds from sales of investment securities	63,425	59,926
Proceeds from maturities of investment securities	21,890	25,422
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(20)	(531)
Sales of Federal Reserve and Federal Home Loan Bank Stock	185	742
Net decrease (increase) in participating interests in mortgage loans	4,278	(1,971)
Cash used to finance divestiture	(10,966)	-
Net decrease in loans held for investment	26,320	26,004
Proceeds from sales of other real estate	2,586	1,413
Proceeds from sales of bank premises and equipment	2,789	105
Additions to bank premises and equipment	(230)	(162)
Net cash (used in) provided by investing activities	<u>(58,970)</u>	<u>89,620</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows, continued
For the Six Months Ended June 30,
(In thousands, unaudited)

	2011	2010
FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	\$ (35,152)	\$ (85,592)
Net increase (decrease) in short-term borrowings	(2,477)	(1,271)
Repayments of Federal Home Loan Bank advances	(50)	(19,800)
Proceeds from Federal Home Loan Bank advances	50	4,800
Net cash (used in)provided by financing activities	(37,629)	(101,863)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(86,467)	(5,644)
CASH AND CASH EQUIVALENTS, beginning of year	112,847	35,362
CASH AND CASH EQUIVALENTS, end of year	\$ 26,379	\$ 29,718
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 3,346	\$ 5,856
Income taxes received	\$ (15)	\$ (6,261)
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to other real estate in settlement of loans	\$ 4,182	\$ 7,264
Loans sold in divestiture	\$ 65,688	\$ -
Deposits transferred in divestiture	\$ 76,654	\$ -

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
June 30, 2011

NOTE 1 – Organization of Operations, BNCCORP, INC.

BNCCORP, INC. (BNCCORP) is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (together with its wholly owned subsidiary, BNC Insurance Services, Inc., collectively the Bank). The Company operates community banking and wealth management businesses in Arizona, Minnesota and North Dakota from 17 locations. The Bank also conducts mortgage banking from 10 locations in Arizona, Minnesota, Iowa, Kansas, Nebraska and Missouri.

The accounting and reporting policies of BNCCORP and its subsidiaries (collectively, the Company) conform to accounting principles generally accepted in the United States of America and general practices within the financial services industry. The consolidated financial statements included herein are for BNCCORP and its subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

NOTE 2 – Basis of Presentation and Accounting Policies

The accompanying interim consolidated financial statements have been prepared under the presumption that users of the interim consolidated financial information have either read or have access to the audited consolidated financial statements for the year ended December 31, 2010. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2010 audited consolidated financial statements have been omitted from these interim consolidated financial statements. It is suggested that these interim consolidated financial statements be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2010 and the notes thereto.

The accompanying interim consolidated financial statements have been prepared by the Company, in accordance with accounting principles generally accepted in the United States of America for interim financial information. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. These estimates are based on information available to management at the time the estimates are made.

The unaudited consolidated financial statements as of June 30, 2011 include, in the opinion of management, all adjustments, consisting solely of normal recurring adjustments, necessary for a fair presentation of the financial results for the respective interim periods and are not necessarily indicative of results of operations to be expected for the entire fiscal year.

The Company's critical accounting policies are unchanged since December 31, 2010.

Recently Issued or Adopted Accounting Standards

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

FASB ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, requires significant new disclosures about the allowance for credit losses and the credit quality

of financing receivables. The requirements are intended to enhance transparency regarding credit losses and the credit quality of loan and lease receivables. Under this statement, allowance for credit losses and fair value are to be disclosed by portfolio segment, while credit quality information, impaired financing receivables and nonaccrual status are to be presented by class of financing receivable. Disclosure of the nature and extent, the financial impact and segment information of troubled debt restructurings will also be required. The disclosures are to be presented at the level of disaggregation that management uses when assessing and monitoring the portfolio's risk and performance. This ASU is effective for interim and annual reporting periods after December 15, 2010 for public companies and on or after December 15, 2011 for non-public companies.

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

FASB ASU No. 2011-02, *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, clarifies when the restructuring of a receivable should be considered a troubled debt restructuring (TDR). FASB issued the guidance in response to constituents' concerns that creditors were inconsistently applying the guidance for indentifying TDRs. The ASU provides additional guidance for determining whether the creditor has granted a concession and whether the debtor is experiencing financial difficulty. The ASU generally will result in creditors identifying more TDRs. For nonpublic companies, this ASU is effective for annual periods ending after December 15, 2012, including interim periods within those annual periods.

Reclassifications

Certain of the 2010 amounts have been reclassified to conform to the 2011 presentations. These reclassifications had no effect on net income or stockholders' equity.

NOTE 3 – Regulatory Capital and Current Operating Environment

Capital amounts and ratios of BNCCORP and the Bank are presented in the tables below (dollars in thousands):

	Actual		To be Well Capitalized	
	Amount	Ratio	Amount	Ratio
June 30, 2011				
Total Capital (to risk-weighted assets):				
Consolidated	\$ 63,092	16.80 %	\$ N/A	N/A
BNC National Bank	63,923	17.06	37,469	10.0 %
Tier 1 Capital (to risk-weighted assets):				
Consolidated	47,857	12.74	N/A	N/A
BNC National Bank	59,161	15.79	22,482	6.0
Tier 1 Capital (to average assets):				
Consolidated	47,857	7.10	N/A	N/A
BNC National Bank	59,161	8.81	33,572	5.0
Tangible Capital (to total assets):				
Consolidated tangible equity	37,204	5.88	N/A	N/A
BNC National Bank	60,926	9.67	N/A	N/A
Tangible Common Capital (to total assets):				
Consolidated tangible common equity	16,617	2.62	N/A	N/A
December 31, 2010				
Total Capital (to risk-weighted assets):				
Consolidated	\$ 63,892	12.89 %	\$ N/A	N/A
BNC National Bank	63,380	12.80	49,515	10.0 %
Tier 1 Capital (to risk-weighted assets):				
Consolidated	46,885	9.46	N/A	N/A
BNC National Bank	57,106	11.53	29,709	6.0
Tier 1 Capital (to average assets):				
Consolidated	46,885	6.17	N/A	N/A
BNC National Bank	57,106	7.53	37,932	5.0
Tangible Capital (to total assets):				
Consolidated tangible equity	37,226	4.98	N/A	N/A
BNC National Bank	59,622	8.00	N/A	N/A
Tangible Common Capital (to total assets):				
Consolidated tangible common equity	16,740	2.24	N/A	N/A

In the current operating environment, management believes banking entities are regularly required to maintain capital ratios in excess of the statutory amounts required to remain well capitalized. We are managing capital accordingly.

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

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

- (1) Develop, and implement a written program to identify and monitor credit and underwriting exceptions from loan policy;
- (2) Adopt, implement and ensure adherence to a written asset diversification program that limits concentrations of assets to prescribed limits; and
- (3) Adopt, implement and ensure adherence to work out plans designed to reduce criticized assets. The work out plans are to be updated quarterly.

Management believes policies and procedures implemented in response to the agreement adequately addressed the articles summarized above. Because regulatory authorities are generally hesitant to remove operating articles within agreements at many institutions, the OCC may need more time to evaluate the effectiveness of our policies and procedures before they will remove the articles.

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

Payments of the holding company's dividends on preferred stock and interest on debt have been suspended since early 2010.

NOTE 4. Fraud Loss on Assets Serviced by Others

As previously reported, the Company discovered fraudulent activity in April of 2010 by an external company that was servicing residential mortgage loans for BNC. Subsequently, the Company and its advisors have been diligently addressing this matter. Our internal and external investigations have confirmed that this fraudulent activity was limited to this external servicing company and that no bank employees were involved in or were aware of this wrongful conduct by the servicing company. As such, we believe these losses are not indicative of other credit quality problems within our loan portfolio.

In 2010, we submitted claims under our fidelity insurance policies seeking to recover the insured portion of these losses. The policies together provide for total coverage of \$15 million. However, in the fourth quarter of 2010, our insurance carriers commenced a declaratory judgment action against the Company in an Arizona federal court seeking a judicial determination that the losses associated with the servicing fraud are not covered by the policies. We have subsequently counter sued the insurance carriers for failure to honor the policies and for acting in bad faith. We intend to vigorously pursue our claims to recover amounts due under the insurance policies and for losses incurred as a result of the carriers acting in bad faith. While management believes we have strong claims, there can be no assurances as to the outcome of this litigation, or if we will recover all or any portion of the insured amounts.

NOTE 5. Divestiture

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

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

As of December 31, 2010, the assets and liabilities included in the divestiture were classified as held for sale. As of December 31, 2010, the carrying value of the loans held for sale related to the divestiture was \$70.5 million. The total loans held for sale as of December 31, 2010 was \$72.2 million and the allowance for losses allocated to these loans at year end was \$1.7 million. The carrying value of premises and equipment held for sale related to the divestiture was \$2.8 million. The carrying value of deposits held for sale related to the divestiture was \$107.5 million.

There was no significant gain or loss incurred as a result of the divestiture.

NOTE 6 – Other Real Estate

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Balance, beginning of period	\$ 12,506	\$ 6,357	\$ 12,706	\$ 7,253
Transfers from nonperforming loans	4,182	7,264	4,182	7,264
Real estate sold	(2,586)	(1,055)	(2,586)	(1,413)
Net gains (losses) on sale of assets	50	(11)	50	(155)
Provision	(200)	(240)	(400)	(634)
Balance, end of period	<u>\$ 13,952</u>	<u>\$ 12,315</u>	<u>\$ 13,952</u>	<u>\$ 12,315</u>

NOTE 7 – Earnings Per Share

The following table shows the amounts used in computing per share results:

	Three months ended June 30, 2011	Six months ended June 30, 2011
Denominator for basic earnings per share:		
Average common shares outstanding	3,282,426	3,283,839
Dilutive common stock options	-	-
Denominator for diluted earnings per share	<u>3,282,426</u>	<u>3,283,839</u>
Numerator:		
Net income	\$ 649	\$ 1,222
Preferred stock costs	(345)	(684)
Net income available to common shareholders	<u>\$ 304</u>	<u>\$ 538</u>
Basic earnings per common share	<u>\$ 0.09</u>	<u>\$ 0.16</u>
Diluted earnings per common share	<u>\$ 0.09</u>	<u>\$ 0.16</u>
	Three months ended June 30, 2010	Six months ended June 30, 2010
Denominator for basic loss per share:		
Average common shares outstanding	3,281,719	3,281,719
Dilutive common stock options	-	-
Denominator for diluted loss per share	<u>3,281,719</u>	<u>3,281,719</u>
Numerator (in thousands):		
Net loss	\$ (25,221)	\$ (23,031)
Preferred stock costs	(331)	(655)
Net loss available to shareholders	<u>\$ (25,552)</u>	<u>\$ (23,686)</u>
Basic loss per common share	<u>\$ (7.79)</u>	<u>\$ (7.22)</u>
Diluted loss per common share	<u>\$ (7.79)</u>	<u>\$ (7.22)</u>

For the three months ended June 30, 2011 and 2010, there were 236,500 options and 281,700 options outstanding, respectively, excluded from the computation of diluted EPS because their exercise prices were higher than the average price of BNCCORP's common stock for the period and are considered anti-dilutive. For the six months ended June 30, 2011 and 2010, there were 236,500 options and 281,700 options outstanding, respectively, excluded from the computation of diluted EPS because their exercise prices were higher than the average price of BNCCORP's common stock for the period.

NOTE 8 – Share-Based Compensation

The Company may grant share-based compensation at prices equal to the fair value of the stock at the grant date. The Company has four share-based plans for certain key employees and directors whereby shares of common stock have been reserved for awards in the form of stock options or restricted stock awards. The plans are as follows:

	1995	2002	2006	2010
Total Shares Available	78,251	-	15,800	250,000
Maximum Restricted Shares Available	78,251	-	15,800	35,000

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

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

The Company recognized share-based compensation expense of \$35,000 for the three month period ending June 30, 2011 and \$70,000 for the six month period ended June 30, 2011 relating to share options. The Company recognized share-based compensation expense of \$41,000 for the three and six month periods ending June 30, 2010 relating to share options. At June 30, 2011, the Company had \$99,000 of unamortized compensation cost related to non-vested stock options granted.

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

Following is a summary of fully vested stock options and options expected to vest as of June 30, 2011:

	Stock Options Outstanding	Stock Options Currently Exercisable	Stock Options Vested and Expected to Vest
Number	236,500	122,500	236,500
Weighted-average exercise price	\$3.14	\$3.28	\$3.14
Weighted-average remaining contractual term	8.5 years	8.25 years	8.5 years

The Company recognized share-based compensation expense of \$12,000 related to restricted stock for the three month period ended June 30, 2011, and \$23,000 for the six month period ended June 30, 2011. The Company recognized share-based compensation expense of \$8,000 related to restricted stock for the three month period ended June 30, 2010, and \$16,000 for the six month period ended June 30, 2010.

At June 30, 2011, the Company had \$53,000 of unamortized restricted stock compensation expense. All of this expense will be amortized by September 1, 2013. The cost of restricted stock granted is recognized over the vesting period, which is generally three or more years.

NOTE 9 – Investment Securities Available for Sale

Investment securities have been classified in the consolidated balance sheets according to management's intent. The Company had no securities designated as trading or held-to-maturity in its portfolio at June 30, 2011 or December 31, 2010. The carrying amount of available-for-sale securities and their approximate fair values were as follows (in thousands):

	As of June 30, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	\$ 28,799	\$ 251	\$ (119)	\$ 28,931
U.S. government agency mortgage-backed securities issued by FNMA	5,036	113	(54)	5,095
Collateralized mortgage obligations guaranteed by GNMA/VA	146,869	1,005	(287)	147,587
Collateralized mortgage obligations issued by FNMA or FHLMC	19,444	292	(14)	19,722
Other collateralized mortgage obligations	16,374	582	(5)	16,951
State and municipal bonds	1,958	254	-	2,212
	<u>\$ 218,480</u>	<u>\$ 2,497</u>	<u>\$ (479)</u>	<u>\$ 220,498</u>

	As of December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	\$ 965	\$ 35	\$ -	\$ 1,000
U.S. government agency mortgage-backed securities issued by FNMA	1,863	116	(1)	1,978
Collateralized mortgage obligations guaranteed by GNMA/VA	89,056	908	(275)	89,689
Collateralized mortgage obligations issued by FNMA or FHLMC	930	67	-	997
Other collateralized mortgage obligations	39,518	1,889	(152)	41,255
State and municipal bonds	1,911	202	-	2,113
	<u>\$ 134,243</u>	<u>\$ 3,217</u>	<u>\$ (428)</u>	<u>\$ 137,032</u>

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at June 30, 2011 were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ -	\$ -
Due after one year through five years	-	-
Due after five years through ten years	2,620	2,861
Due after ten years	215,860	217,637
Total	<u>\$ 218,480</u>	<u>\$ 220,498</u>

Actual maturities may differ from the contractual maturities shown above as a result of prepayments.

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

June 30, 2011

Description of Securities	Less than 12 months			12 months or more			Total		
	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
	U.S. government agency mortgage-backed securities guaranteed by GNMA	2	\$ 8,777	\$ (119)	-	\$ -	\$ -	2	\$ 8,777
U.S. government agency mortgage-backed securities issued by FNMA	1	3,276	(52)	1	56	(2)	2	3,332	(54)
Collateralized mortgage obligations guaranteed by GNMA/VA	6	27,658	(287)	-	-	-	6	27,658	(287)
Collateralized mortgage obligations issued by FNMA or FHLMC	1	3,734	(14)	-	-	-	1	3,734	(14)
Other collateralized mortgage obligations	1	257	(5)	-	-	-	1	257	(5)
State and municipal bonds	-	-	-	-	-	-	-	-	-
Total temporarily impaired securities	<u>11</u>	<u>\$ 43,702</u>	<u>\$ (477)</u>	<u>1</u>	<u>\$ 56</u>	<u>\$ (2)</u>	<u>12</u>	<u>\$ 43,758</u>	<u>\$ (479)</u>

December 31, 2010

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

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

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

All securities in an unrealized loss position are investment grade. For the non-agency security with an unrealized loss at June 30, 2011, the collateral is generally based on loans originated between 2002 and 2003, and as a result the loan to value ratios of the underlying loans, in addition to the credit support provided by tranches subordinate to this security, generally indicates risk of loss is relatively low.

There were no securities that management concluded were other-than-temporarily impaired at June 30, 2011.

NOTE 10 – Fair Value Measurements

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

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

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market and are used only to the extent that observable inputs are not available. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The following tables summarize the financial assets and liabilities of the Company for which fair values are determined on a recurring basis (in thousands):

	Carrying Value at June 30, 2011			
	Total	Level 1	Level 2	Level 3
ASSETS				
Securities available for sale	\$ 220,498	\$ -	\$ 220,498	\$ -
Loans held for sale	30,269	-	30,269	-
Commitments to originate mortgage loans	904	-	904	-
Total assets at fair value	<u>\$ 251,671</u>	<u>\$ -</u>	<u>\$ 251,671</u>	<u>\$ -</u>
LIABILITIES				
Commitments to sell mortgage loans	\$ 1,523	\$ -	\$ 1,523	\$ -
Total liabilities at fair value	<u>\$ 1,523</u>	<u>\$ -</u>	<u>\$ 1,523</u>	<u>\$ -</u>

	Carrying Value at December 31, 2010			
	Total	Level 1	Level 2	Level 3
ASSETS				
Securities available for sale	\$ 137,032	\$ -	\$ 137,032	\$ -
Loans held for sale	29,116	-	29,116	-
Commitments to originate mortgage loans	488	-	488	-
Total assets at fair value	<u>\$ 166,636</u>	<u>\$ -</u>	<u>\$ 166,636</u>	<u>\$ -</u>
LIABILITIES				
Commitments to sell mortgage loans	\$ 470	\$ -	\$ 470	\$ -
Total liabilities at fair value	<u>\$ 470</u>	<u>\$ -</u>	<u>\$ 470</u>	<u>\$ -</u>

At the beginning of the period, all assets and liabilities valued at fair value on a recurring basis were considered to be Level 2. There were no transfers into or out of Level 2 during the period.

Changes in the fair value of assets and liabilities determined on a recurring basis had no net impact on our Consolidated Statements of Operations for the three month and six month periods ending June 30, 2011 and June 30, 2010.

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

	Carrying Value at June 30, 2011				Six Months Ended June 30, 2011
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 10,918	\$ -	\$ 10,918	\$ -	\$ (461)
Other real estate ⁽²⁾	13,952	-	13,952	-	(350)
Total	\$ 24,870	\$ -	\$ 24,870	\$ -	\$ (811)

	Carrying Value at December 31, 2010				Twelve Months Ended December 31, 2010
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 15,152	\$ -	\$ 15,152	\$ -	\$ (2,260)
Other real estate ⁽²⁾	12,706	-	12,706	-	(2,509)
Total	\$ 27,858	\$ -	\$ 27,858	\$ -	\$ (4,769)

(1) Represents the carrying value and related write-downs of loans based on the appraised value of the collateral.

(2) Represents the fair value of the collateral less estimated selling costs and is based upon appraised values.

At the beginning of the period, all assets and liabilities valued at fair value on a nonrecurring basis were considered to be Level 2. There were no transfers into or out of Level 2 during the period.

NOTE 11. Fair Value of Financial Instruments

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

	June 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
Cash and cash equivalents	\$ 26,379	\$ 26,379	\$ 112,847	\$ 112,847
Investment securities available for sale	220,498	220,498	137,032	137,032
Federal Reserve Bank and Federal Home Loan Bank stock	2,697	2,697	2,862	2,862
Loans held for sale-mortgage banking	30,269	30,269	29,116	29,116
Participating interests in mortgage loans	609	609	4,888	4,888
Loans and leases held for investment, net	301,428	300,087	335,736	334,413
Other loans held for sale, net	-	-	70,501	70,501
Accrued interest receivable	2,236	2,236	2,138	2,138
	<u>584,116</u>	<u>\$ 582,775</u>	<u>695,120</u>	<u>\$ 693,797</u>
Other assets			49,180	
Other assets held for sale	48,917		2,769	
	<u>\$ 633,033</u>		<u>\$ 747,069</u>	
Liabilities and Stockholders' Equity:				
Deposits, noninterest-bearing	\$ 92,538	\$ 92,538	\$ 91,478	\$ 91,478
Deposits, interest-bearing	456,767	457,485	462,187	461,944
Deposits, non-interest-bearing held for sale	-	-	34,610	34,610
Deposits, interest-bearing held for sale	-	-	72,836	72,836
Borrowings and advances	13,852	13,852	16,329	16,329
Accrued interest payable	3,187	3,187	2,561	2,561
Accrued expenses	4,635	4,635	4,704	4,704
Guaranteed preferred beneficial interests in Company's subordinated debentures	22,426	11,980	22,425	9,647
	<u>593,405</u>	<u>\$ 583,677</u>	<u>707,130</u>	<u>\$ 694,109</u>
Other liabilities	2,349		2,618	
Stockholders' equity	37,279		37,321	
	<u>\$ 633,033</u>		<u>\$ 747,069</u>	
Financial instruments with off-balance-sheet				
Commitments to extend credit		\$ 19		\$ 31
Standby and commercial letters of credit		32		37
Mortgage banking commitments to fund		904		488
Mortgage banking commitments to sell		1,523		470
		<u>\$ 2,478</u>		<u>\$ 1,026</u>

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

For purposes of Items 2 and 3 of this report, we refer to (we), (our) or (the Company) when such reference includes BNCCORP, INC. and its consolidated subsidiaries, collectively; (BNCCORP) when referring only to BNCCORP, INC.; (the Bank) when referring only to BNC National Bank.

Comparison of Results for the Three and Six Months Ended June 30, 2011 and 2010

Summary for the Three Months Ended June 30, 2011 and 2010

Net income was \$649 thousand, and the net income available to common shareholders was \$304 thousand, or \$0.09 per share on a diluted basis, for the quarter ended June 30, 2011, compared to a net loss of \$(25.221) million or \$(7.79) per diluted share, in the second quarter of 2010. The results of the second quarter 2010 include a fraud loss on assets serviced by others of \$(26.231) million.

Net interest income for the second quarter of 2011 was \$4.696 million, a decrease of \$1.117 million, or 19.2%, from \$5.813 million in the same period of 2010. The net interest margin for the current period decreased to 3.07% from 3.20%.

In the second quarter of 2011 and 2010, the Company's provision for credit losses was \$500 thousand and \$1.500 million, respectively.

Non-interest income for the second quarter of 2011 was \$4.717 million. This compares to non-interest income of \$5.560 million for the same period in 2010, a decrease of \$843 thousand, or 15.2%.

Non-interest expense for the second quarter of 2011 was \$8.262 million compared to \$8.743 million in 2010, excluding the fraud loss on assets serviced by others of \$(26.231) million, a decrease of \$481 thousand, or 5.5%.

Tax expense of \$2 thousand was recognized during the second quarter of 2011. Although the Company has net operating loss carryforwards for federal tax purposes aggregating \$8.574 million, a provision for taxes was recorded in the second quarter for miscellaneous state obligations. Due to the Company's full valuation allowance and its tax loss carryforwards, the Company is not likely to record significant income tax expense for several profitable periods. A tax expense of \$120 thousand, or 0.5% of pre-tax loss, was recognized during the second quarter of 2010.

Summary for the Six Months Ended June 30, 2011 and 2010

Net income was \$1.222 million, and the income available to common shareholders was \$538 thousand, or \$0.16 per share on a diluted basis, for the six months ended June 30, 2011. For the six months ended June 30, 2010, the net loss was \$(23.031) million, and the loss available to common shareholders was \$(23.686) million, or \$(7.22) per share on a diluted basis. The results for the first half of 2010 include a fraud loss on assets serviced by others of \$(26.231) million.

Net interest income for the six months ended June 30, 2011 was \$9.856 million, a decrease of \$2.295 million, or 18.9%, from \$12.151 million in the same period of 2010. The year to date net interest margin decreased to 3.04% from 3.24%.

In the first six months of 2011 and 2010, the Company's provision for credit losses was \$1.100 million and \$3.500 million, respectively.

Non-interest income for the six months ended June 30, 2011 was \$8.753 million. This compares to non-interest income of \$11.846 million for the same period in 2010, a decrease of \$3.093 million, or 26.1%.

Non-interest expense for the six months ended June 30, 2011 was \$16.285 million compared to \$17.225 million, excluding the fraud loss on assets service by others of \$(26.231), in the same period of 2010, a decrease of \$940 thousand, or 5.5%.

Tax expense of \$2 thousand was recognized during the six month period ended June 30, 2011. Although the Company has net operating loss carryforwards aggregating \$8.574 million for federal tax purposes, a provision for taxes was recorded in 2011 for state tax obligations. Due to the Company's full valuation allowance and its tax loss carryforwards, the Company is not likely to record significant income tax expense for several profitable periods. Tax expense in the first six months of 2010 was \$72 thousand, or 0.31% of pre-tax losses.

Net Interest Income

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

	Three Months Ended June 30,								
	2011			2010			Change		
	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost
Interest-earning assets									
Federal funds sold/cash equivalents	\$ 63,577	\$ 50	0.32%	\$ 31,567	\$ 21	0.27%	\$ 32,010	\$ 29	0.05%(a)
Investments - taxable	218,146	2,077	3.82%	172,164	2,308	5.38%	45,982	(231)	-1.56%(b)
Investments - tax exempt	2,189	24	4.40%	2,023	23	4.56%	166	1	-0.16%
Loans held for sale – mortgage banking	21,528	219	4.08%	21,522	263	4.90%	6	(44)	-0.82%(c)
Participating interests in mortgage loans	1,487	15	4.05%	19,423	(38)	-0.78%	(17,936)	53	4.83%(d)
Loans and leases held for investment	319,993	3,871	4.85%	498,627	5,874	4.73%	(178,634)	(2,003)	0.12%(e)
Allowance for loan losses	(13,220)	-		(17,807)	-		4,587	-	
Total interest-earning assets	<u>\$ 613,700</u>	<u>\$ 6,256</u>	4.09%	<u>\$ 727,519</u>	<u>\$ 8,451</u>	4.66%	<u>\$ (113,819)</u>	<u>\$ (2,195)</u>	-0.57%
Interest-bearing liabilities									
Interest checking and money market accounts	\$ 241,791	\$ 227	0.38%	\$ 282,133	\$ 439	0.62%	\$ (40,342)	\$ (212)	-0.24%(f)
Savings	12,246	3	0.10%	11,106	3	0.11%	1,140	-	-0.01%
Certificates of deposit under \$100,000	172,802	796	1.85%	243,090	1,614	2.66%	(70,288)	(818)	-0.81%(f)
Certificates of deposit \$100,000 and over	40,803	166	1.63%	44,246	249	2.20%	(3,443)	(83)	-0.63%(f)
Total interest-bearing deposits	467,642	1,192	1.02%	580,575	2,305	1.59%	(112,933)	(1,113)	-0.57%
Short-term borrowings	14,385	34	0.95%	9,548	15	0.63%	4,837	19	0.32%(g)
Federal Home Loan Bank advances	1	-	0.00%	143	-	0.00%	(142)	-	0.00%(h)
Other borrowings	-	-	0.00%	13	-	0.00%	(13)	-	0.00%
Subordinated debentures	24,615	334	5.44%	23,325	318	5.47%	1,290	16	-0.03%
Total borrowings	39,001	368	3.78%	33,029	333	4.04%	5,972	35	-0.26%
Total interest-bearing liabilities	<u>\$ 506,643</u>	<u>1,560</u>	1.24%	<u>\$ 613,604</u>	<u>2,638</u>	1.72%	<u>\$ (106,961)</u>	<u>(1,078)</u>	-0.48%
Net interest income/spread		<u>\$ 4,696</u>	2.85%		<u>\$ 5,813</u>	2.94%		<u>\$ (1,117)</u>	-0.09%
Net interest margin			3.07%			3.20%			-0.13%
Notation:									
Non-interest-bearing deposits	<u>\$ 123,149</u>	-		<u>\$ 116,074</u>	-		<u>\$ 7,075</u>	-	
Total deposits	<u>\$ 590,791</u>	<u>\$ 1,192</u>	0.81%	<u>\$ 696,649</u>	<u>\$ 2,305</u>	1.33%	<u>\$ (105,858)</u>	<u>\$ (1,113)</u>	-0.52%
Taxable equivalents:									
Total interest-earning assets	\$ 613,700	\$ 6,271	4.10%	\$ 727,519	\$ 8,491	4.68%	(113,819)	\$ (2,220)	-0.58%
Net interest income/spread	-	\$ 4,711	2.86%	-	\$ 5,854	2.96%	-	\$ (1,143)	-0.10%
Net interest margin	-	-	3.08%	-	-	3.23%	-	-	-0.15%

Overall, interest rates on assets and liabilities have declined due to the general decline of interest rates.

- We steadily increased liquidity in 2010 and early 2011 until the branch divestiture (see Note 5) was completed.
- Since the branch divestiture was completed, we have been deploying cash into investments.
- The balance of loans held for sale can vary depending on the volume of loans originated and efficiency with which the loans are sold.
- We stopped offering this product in 2011. See also Note 4 to the quarterly report.
- The balance of loans has declined due to repayments, sales and charge-offs.
- Deposits have decreased due to the branch divestiture discussed in Note 5 and efforts to reduce the cost of funds have resulted in declining balances of certificates.
- Short term borrowings will vary depending on our customers need to use repurchase agreements.
- The average balance of FHLB advances decreased because we have been able to fund more of our assets with deposits.

Six Months Ended June 30,

	2011			2010			Change		
	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost
Interest-earning assets									
Federal funds sold/cash equivalents	\$ 99,198	\$ 129	0.26%	\$ 37,456	\$ 46	0.25%	\$ 61,742	\$ 83	0.01%(a)
Investments - taxable	190,332	3,821	4.05%	185,255	5,016	5.46%	5,077	(1,195)	-1.41%(b)
Investments - tax exempt	2,151	48	4.50%	2,046	46	4.53%	105	2	-0.03%
Loans held for sale – mortgage banking	18,588	405	4.39%	18,841	460	4.92%	(253)	(55)	-0.53%(c)
Participating interests in mortgage loans	1,693	34	4.05%	26,580	361	2.74%	(24,887)	(327)	1.31%(d)
Loans and leases held for investment	357,223	8,726	4.93%	504,659	11,811	4.72%	(147,436)	(3,085)	0.21%(e)
Allowance for loan losses	(14,602)	-		(17,701)	-		3,099	-	
Total interest-earning assets	<u>\$ 654,583</u>	<u>\$ 13,163</u>	4.06%	<u>\$ 757,136</u>	<u>\$ 17,740</u>	4.72%	<u>\$ (102,553)</u>	<u>\$ (4,577)</u>	-0.66%
Interest-bearing liabilities									
Interest checking and money market accounts	\$ 255,029	\$ 556	0.44%	\$ 278,395	\$ 941	0.68%	\$ (23,366)	\$ (385)	-0.24%
Savings	12,566	6	0.10%	10,869	5	0.09%	1,697	1	0.01%
Certificates of deposit under \$100,000	182,960	1,668	1.84%	270,042	3,375	2.52%	(87,082)	(1,707)	-0.68%(f)
Certificates of deposit \$100,000 and over	42,402	342	1.63%	46,918	520	2.24%	(4,516)	(178)	-0.61%(f)
Total interest-bearing deposits	492,957	2,572	1.05%	606,224	4,841	1.61%	(113,267)	(2,269)	-0.56%
Short-term borrowings	16,237	69	0.86%	9,330	31	0.67%	6,907	38	0.19%(g)
Federal Home Loan Bank advances	-	-	0.00%	5,798	113	3.93%	(5,798)	(113)	-3.93%(h)
Other borrowings	-	-	0.00%	20	-	0.00%	(20)	-	0.00%
Subordinated debentures	24,448	666	5.49%	23,181	604	5.25%	1,267	62	0.24%
Total borrowings	40,685	735	3.64%	38,329	748	3.94%	2,356	(13)	-0.30%
Total interest-bearing liabilities	<u>\$ 533,642</u>	<u>3,307</u>	1.25%	<u>\$ 644,553</u>	<u>5,589</u>	1.75%	<u>\$ (110,911)</u>	<u>(2,282)</u>	-0.50%
Net interest income/spread		<u>\$ 9,856</u>	2.81%		<u>\$ 12,151</u>	2.97%		<u>\$ (2,295)</u>	-0.16%
Net interest margin			3.04%			3.24%			-0.20%
Notation:									
Non-interest-bearing deposits	<u>\$ 138,308</u>	-		<u>\$ 110,947</u>	-		<u>\$ 27,361</u>	-	
Total deposits	<u>\$ 631,265</u>	<u>\$ 2,572</u>	0.82%	<u>\$ 717,171</u>	<u>\$ 4,841</u>	1.36%	<u>\$ (85,906)</u>	<u>\$ (2,269)</u>	-0.54%
Taxable equivalents:									
Total interest-earning assets	\$ 654,583	\$ 13,194	4.06%	\$ 757,136	\$ 17,796	4.74%	(102,553)	\$ (4,602)	-0.67%
Net interest income/spread	-	\$ 9,887	2.81%	-	\$ 12,207	2.99%	-	\$ (2,320)	-0.17%
Net interest margin	-	-	3.05%	-	-	3.25%	-	-	-0.19%

Overall, interest rates on assets and liabilities have declined due to the general decline of interest rates.

- We steadily increased liquidity in 2010 and early 2011 until the branch divestiture (see Note 5) was completed.
- Since the branch divestiture was completed, we have been deploying cash into investments.
- The balance of loans held for sale can vary depending on the volume of loans originated and efficiency with which the loans are sold.
- We stopped offering this product in 2011. See also Note 4 to the quarterly report.
- The balance of loans has declined due to repayments, sales and charge-offs.
- Deposits have decreased due to the branch divestiture discussed in Note 5 and efforts to reduce the cost of funds have resulted in declining balances of certificates.
- Short term borrowings will vary depending on our customers need to use repurchase agreements.
- The average balance of FHLB advances decreased because we have been able to fund more of our assets with deposits.

Non-interest Income

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

	Three Months Ended				Six Months Ended			
	June 30,		Increase (Decrease)		June 30,		Increase (Decrease)	
	2011	2010	\$	%	2011	2010	\$	%
Bank charges and service fees	\$ 573	\$ 582	\$ (9)	(2) %	\$ 1,133	\$ 1,199	\$ (66)	(6) %
Wealth management revenues	332	590	(258)	(44) %	717	1,161	(444)	(38) % (a)
Mortgage banking revenues	2,287	2,829	(542)	(19) %	4,350	5,014	(664)	(13) % (b)
Gains on sales of loans, net	412	-	412	100 %	900	-	900	100 % (c)
Gains on sales of securities, net	835	1,368	(533)	(39) %	1,196	3,873	(2,677)	(69) % (d)
Other	278	191	87	46 %	457	599	(142)	(24) % (e)
Total non-interest income	<u>\$ 4,717</u>	<u>\$ 5,560</u>	<u>\$ (843)</u>	(15) %	<u>\$ 8,753</u>	<u>\$ 11,846</u>	<u>\$ (3,093)</u>	(26) %

- (a) Wealth management revenues are expected to decrease in 2011 as we have exited the ESOP trustee business and the custodial services for insurance products sold by third parties.
- (b) The housing industry is currently experiencing challenges and the ability to generate mortgage banking revenues will be impacted by the industry's recovery, interest rates and governmental influences.
- (c) Gains and losses on sales will vary significantly from period to period. Gains on sales of loans are likely to be higher in 2011 as we plan to continue selling the guaranteed portion of certain SBA loans we originate.
- (d) Gains and losses on sales will vary significantly from period to period.
- (e) In early 2010 we sold a branch at a gain of \$403 thousand.

Non-interest Expense

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

	Three Months Ended				Six Months Ended			
	June 30,		Increase (Decrease)		June 30,		Increase (Decrease)	
	2011	2010	\$	%	2011	2010	\$	%
Salaries and employee benefits	\$ 3,655	\$ 3,893	\$ (238)	(6) %	\$ 7,668	\$ 7,993	\$ (325)	(4) % (a)
Professional services	1,100	1,353	(253)	(19) %	1,837	2,118	(281)	(13) % (b)
Data processing fees	696	666	30	5 %	1,381	1,268	113	9 %
Occupancy	480	697	(217)	(31) %	1,066	1,428	(362)	(25) % (c)
Regulatory costs	476	443	33	7 %	992	828	164	20 % (d)
Marketing and promotion	406	344	62	18 %	720	674	46	7 %
Other real estate costs	356	278	78	28 %	677	732	(55)	(8) % (e)
Depreciation and amortization	295	322	(27)	(8) %	592	653	(61)	(9) %
Office supplies and postage	137	156	(19)	(12) %	282	306	(24)	(8) %
Fraud loss on assets serviced by others	-	26,231	(26,231)	(100) %	-	26,231	(26,231)	(100) % (f)
Other	661	591	70	12 %	1,070	1,225	(155)	(13) %
Total non-interest expense	<u>\$ 8,262</u>	<u>\$ 34,974</u>	<u>\$ (26,712)</u>	(76) %	<u>\$ 16,285</u>	<u>\$ 43,456</u>	<u>\$ 27,171</u>	(63) %
Efficiency ratio	<u>87.8%</u>	<u>307.0%</u>			<u>87.5%</u>	<u>181.0%</u>		

- (a) Salaries have decreased due to branch sale and efforts to control costs.
- (b) Professional services costs will be impacted by mortgage banking activities and legal/investigative costs related to the fraud loss on assets serviced by others.
- (c) Occupancy costs have declined as we have closed and relocated branches to reduce costs.
- (d) Regulatory costs have generally been increasing for financial institutions.
- (e) Other real estate costs will vary depending on the need to reduce carrying values of foreclosed properties.
- (f) See Note 4 to the financial statements.

Income Taxes

Tax expense of \$2 thousand was recognized during the second quarter of 2011. Although the Company has net operating loss carryforwards for federal tax purposes aggregating \$8.574 million, a provision for taxes was recorded in the second quarter for miscellaneous state obligations. Due to the Company's full valuation allowance and its tax loss carryforwards, the Company is not likely to record significant income tax expense for several profitable periods. A tax expense of \$120 thousand, or 0.5% of pre-tax loss, was recognized during the second quarter of 2010.

Comparison of Financial Condition at June 30, 2011 and December 31, 2010

Assets

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

	June 30,	December 31,	Increase (Decrease)			
	2011	2010	\$	%		
Cash and cash equivalents	\$ 26,379	\$ 112,847	\$ (86,468)	(77)	%	(a)
Investment securities available for sale	220,498	137,032	83,466	61	%	(b)
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	2,697	2,862	(165)	(6)	%	
Loans held for sale-mortgage banking	30,269	29,116	1,153	4	%	(c)
Participating interests in mortgage loans	609	4,888	(4,279)	(88)	%	
Loans and leases held for investment, net	301,428	335,736	(34,308)	(10)	%	(d)
Other loans held for sale	-	70,501	(70,501)	(100)	%	(f)
Other real estate, net	13,952	12,706	1,246	10		
Premises and equipment, net	16,313	16,684	(371)	(2)		
Interest receivable	2,236	2,138	98	5	%	
Other assets	18,652	19,790	(1,138)	(6)	%	(e)
Premises and equipment held for sale, net	-	2,769	(2,769)	(100)	%	(f)
Total assets	<u>\$ 633,033</u>	<u>\$ 747,069</u>	<u>\$ (114,036)</u>	(15)	%	

- (a) Cash balances have decreased as funds were invested or used to finance the branch divestiture.
- (b) Investments have increased as we have deployed liquidity.
- (c) The balance of loans held for sale can vary depending on the volume of loans originated and efficiency with which the loans are sold.
- (d) The balance of loans has declined due to repayments, sales and charge-offs.
- (e) Included in other assets is an investment in a SBIC fund, which is accounted for using the cost method of accounting, aggregating \$1,197. We have been notified a dividend may be received in the third quarter.
- (f) These balances decreased when our divestiture was consummated – see Note 5.

Loans and Leases Held For Investment Portfolio

The following table presents the composition of our loans and leases held for investment portfolio as of the dates indicated (dollars are in thousands):

	June 30, 2011		December 31, 2010		Increase (Decrease)	
	Amount	%	Amount	%	Amount	%
Commercial and industrial	\$ 66,420	22.0	\$ 76,617	22.5	\$ (10,197)	(13) % (a)
Real estate mortgage	189,233	62.7	211,852	62.2	(22,619)	(11) % (a)
Real estate construction	35,762	11.8	40,986	12.0	(5,224)	(13) % (a)
Participating interests in mortgage loans	609	0.2	4,888	1.4	(4,279)	(88) % (b)
Agricultural	15,200	5.0	15,114	4.4	86	1 %
Other	6,033	2.0	6,229	1.8	(196)	(3) %
Total principal amount of loans	313,257	103.7	355,686	104.4	(42,429)	(12) %
Unearned income and net unamortized deferred fees and costs	(175)	-	(297)	(0.1)	122	(41) %
Loans, net of unearned income and unamortized fees and costs	313,082	103.7	355,389	104.3	(42,307)	(12) % (a)
Less allowance for credit losses	(11,045)	(3.7)	(14,765)	(4.3)	3,720	(25) % (c)
Net loans	\$ 302,037	100.0	\$ 340,624	100.0	\$ (38,587)	(11) %

- (a) On an overall basis loans have decreased due to repayments and sales. Construction loans decreased because construction projects have been completed and reclassified to real estate mortgage loans.
- (b) See Note 4 to the quarterly report.
- (c) See allowance for credit losses section of this document.

Loan Participations

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

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

Loan participations sold on a nonrecourse basis to outside financial institutions were \$233.2 million as of June 30, 2011 and \$259.9 million as of December 31, 2010.

Concentrations of Credit

The following table summarizes the locations and current balances of our borrowers (in thousands):

	June 30, 2011			December 31, 2010		
	Amount	%		Amount	%	
North Dakota	\$ 153,799	49 %		\$ 170,582	48 %	
Minnesota	72,644	23		90,255	25	
Arizona	35,439	11		40,818	12	
Other	51,375	17		54,031	15	
Totals	\$ 313,257	100 %		\$ 355,686	100 %	

Our borrowers use loan proceeds for projects in various geographic areas. The following table summarizes the locations and current balances where our borrowers are using loan proceeds (in thousands):

	<u>June 30, 2011</u>			<u>December 31, 2010</u>		
North Dakota	\$	147,242	47 %	\$	162,364	46 %
Arizona		40,167	13		51,631	14
Texas		24,262	8		26,761	7
California		23,564	8		27,448	8
Minnesota		22,839	7		31,696	9
Kentucky		10,598	3		10,717	3
Idaho		8,857	3		9,095	3
Wisconsin		6,870	2		7,000	2
Colorado		7,937	2		6,333	2
Other		20,921	7		22,641	6
Totals	\$	<u>313,257</u>	<u>100 %</u>	\$	<u>355,686</u>	<u>100 %</u>

The following table presents loans by type within our three primary banking markets (in thousands):

	<u>June 30, 2011</u>		<u>December 31, 2010</u>	
North Dakota				
Commercial and industrial	\$	66,779	\$	80,536
Construction		894		1,029
Agricultural		14,678		13,673
Land and land development		10,626		10,682
Owner-occupied commercial real estate		24,999		24,941
Non-owner-occupied commercial real estate		12,145		12,567
Small business administration		2,458		3,116
Consumer/participating interests		14,663		15,820
Subtotal	\$	<u>147,242</u>	\$	<u>162,364</u>
Arizona				
Commercial and industrial	\$	2,615	\$	606
Construction		-		-
Agricultural		-		-
Land and land development		8,423		8,621
Owner-occupied commercial real estate		559		814
Non-owner-occupied commercial real estate		18,769		26,797
Small business administration		5,682		7,446
Consumer/participating interests		4,119		7,347
Subtotal	\$	<u>40,167</u>	\$	<u>51,631</u>
Minnesota				
Commercial and industrial	\$	848	\$	627
Construction		2,223		2,002
Agricultural		27		30
Land and land development		4,490		4,600
Owner-occupied commercial real estate		1,011		736
Non-owner-occupied commercial real estate		13,312		17,422
Small business administration		255		58
Consumer/participating interests		673		1,973
Subtotal	\$	<u>22,839</u>	\$	<u>27,448</u>

Loan Maturities (1)

The following table sets forth the remaining maturities of loans in each major category of our portfolio as of June 30, 2011 (in thousands):

	One year or less	Over 1 year through 5 years		Over 5 years		Total
		Fixed Rate	Floating Rate	Fixed Rate	Floating rate	
Commercial and industrial	\$ 31,144	\$ 22,041	\$ 2,289	\$ 6,975	\$ 3,971	\$ 66,420
Real estate mortgage	39,938	68,559	40,690	23,884	16,162	189,233
Real estate construction	9,370	8,418	12,754	511	4,709	35,762
Participating interests in mortgage loans	609	-	-	-	-	609
Agricultural	6,656	5,959	588	523	1,474	15,200
Other	1,856	3,005	425	214	533	6,033
Total principal amount of loans	\$ 89,573	\$ 107,982	\$ 56,746	\$ 32,107	\$ 26,849	\$ 313,257

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

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

Allowance for Credit Losses

The following table sets forth information regarding changes in our allowance for credit losses (dollars are in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Balance, beginning of period	\$ 14,176	\$ 18,195	\$ 16,476	\$ 18,047
Provision for credit losses	500	1,500	1,100	3,500
Loans charged off	(3,722)	(1,533)	(5,021)	(3,413)
Loans recovered	91	8	121	36
Transferred with branch divestiture	-	-	(1,631)	-
Balance, end of period	\$ 11,045	\$ 18,170	\$ 11,045	\$ 18,170
Total loans	\$ 343,351	\$ 522,479		
Loans and leases held for investment	\$ 312,473	\$ 480,463		
Allowance for credit losses as a percentage of total loans	3.22%	3.48%		
Allowance for credit losses as a percentage of loans and leases held for investment	3.53%	3.78%		

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2011	2010	2011	2010
Ratio of net charge-offs to average total loans	(1.059)%	(0.283)%	(1.298)%	(0.614)%
Ratio of net charge-offs to average loans and leases held for investment	(1.135)%	(0.306)%	(1.372)%	(0.669)%
Ratio of net charge-offs to average total loans, annualized	(4.234)%	(1.131)%	(2.596)%	(1.228)%
Ratio of net charge-offs to average loans and leases held for investment, annualized	(4.539)%	(1.223)%	(2.743)%	(1.338)%

The provision for credit losses was \$500 thousand in the second quarter of 2011 and \$1.500 million in the second quarter of 2010.

The following table summarizes activity and other information related to the allowance for credit losses as of June 30 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Balance of allowance for credit losses, beginning of period	\$ 14,176	\$ 18,195	\$ 16,476	\$ 18,047
Charge-offs:				
Commercial and industrial	(99)	(683)	(99)	(765)
Real estate mortgage	(3,141)	-	(4,439)	(201)
Real estate construction	(477)	(844)	(477)	(2,440)
Agricultural	-	-	-	-
Other	(5)	(6)	(6)	(7)
Total charge-offs	(3,722)	(1,533)	(5,021)	(3,413)
Recoveries:				
Commercial and industrial	47	5	48	19
Real estate mortgage	12	-	12	-
Real estate construction	29	-	42	9
Agricultural	-	-	-	-
Other	3	3	19	8
Total recoveries	91	8	121	36
Net charge-offs	(3,631)	(1,525)	(4,900)	(3,377)
Provision for credit losses charged to operations	500	1,500	1,100	3,500
Transferred with branch divestiture	-	-	(1,631)	-
Balance of allowance for credit losses, end of period	\$ 11,045	\$ 18,170	\$ 11,045	\$ 18,170
Ratio of net charge-offs to average total loans	(1.059)%	(0.283)%	(1.298)%	(0.614)%
Ratio of net charge-offs to average loans and leases held for investment	(1.135)%	(0.306)%	(1.372)%	(0.669)%
Average gross loans and leases held for investment	\$ 319,993	\$ 498,627	\$ 357,223	\$ 504,659
Ratio of allowance for credit losses to loans and leases held for investment	3.53%	3.78%		
Ratio of allowance for credit losses to nonperforming loans	101%	74%		

The ratio of allowance for credit losses to total loans varies according to the economic conditions, the amount and trend of nonperforming loans, declines in collateral values and other factors that influence management's ongoing evaluation of the loan portfolio.

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

Allocation of the Allowance for Loan Losses

	June 30, 2011		December 31, 2010	
	Amount of allowance	Loans in category as a percentage of total gross loans	Amount of allowance	Loans in category as a percentage of total gross loans
Commercial and industrial	\$ 1,176	21%	\$ 1,078	22%
Real estate mortgage	6,777	61%	11,406	60%
Real estate construction	2,834	11%	1,995	11%
Participating interests in mortgage loans	3	0%	14	1%
Agricultural	170	5%	174	4%
Other	85	2%	98	2%
Total	<u>\$ 11,045</u>	<u>100%</u>	<u>\$ 14,765</u>	<u>100%</u>

We do not originate sub-prime single family loans. We do have a significant portion of our portfolio in construction and commercial real estate. While the Company believes these loans are adequately secured, there has been a significant slow down in the construction and commercial real estate market. We continue to closely monitor all loans, but particularly those in deteriorating industries.

Nonperforming Loans

The following table sets forth information concerning our nonperforming loans as of the dates indicated (dollars are in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Balance, beginning of period	\$ 19,849	\$ 33,852	\$ 17,862	\$ 35,890
Additions to nonperforming	79	3,701	6,258	4,746
Charge-offs	(1,653)	(815)	(2,945)	(2,634)
Reclassified back to performing	(1,967)	(4,111)	(1,967)	(4,111)
Principal payment received	(1,234)	(2,180)	(4,134)	(3,444)
Transferred to other real estate owned	(4,182)	(5,765)	(4,182)	(5,765)
Balance, end of period	<u>\$ 10,892</u>	<u>\$ 24,682</u>	<u>\$ 10,892</u>	<u>\$ 24,682</u>

Nonperforming Assets

The following table sets forth information concerning our nonperforming assets as of the dates indicated (dollars are in thousands):

	<u>June 30, 2011</u>	<u>December 31, 2010</u>
Nonperforming loans:		
Loans 90 days or more delinquent and still accruing interest	\$ 1	\$ -
Non-accrual loans	10,891	17,862
Total nonperforming loans	<u>10,892</u>	<u>17,862</u>
Other real estate, net	13,952	12,706
Total nonperforming assets	<u>\$ 24,844</u>	<u>\$ 30,568</u>
Allowance for credit losses	<u>\$ 11,045</u>	<u>\$ 14,765</u>
Ratio of total nonperforming loans to total loans	3.17%	3.93%
Ratio of total nonperforming loans to loans and leases held for investment	3.49%	5.10%
Ratio of total nonperforming assets to total assets	3.92%	4.09%
Ratio of allowance for credit losses to nonperforming loans	101%	83%

Loans 90 days or more delinquent and still accruing interest include loans over 90 days past due which we believe, based on our specific analysis of the loans, do not present doubt about the collection of interest and principal in accordance with the loan contract. Loans in this category must be well-secured and in the process of collection.

Non-accrual loans

Non-accrual loans include loans on which the accrual of interest has been discontinued. Accrual of interest is discontinued when we believe, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that the collection of interest is doubtful. A delinquent loan is generally placed on non-accrual status when it becomes 90 days or more past due unless the loan is well-secured and in the process of collection. When a loan is placed on non-accrual status, accrued but uncollected interest income applicable to the current reporting period is reversed against interest income of the current period. Accrued but uncollected interest income applicable to previous reporting periods is charged against the allowance for credit losses. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. When problem loans are restructured or resolved otherwise, there may be additional write-downs or charge-offs of principal. These events may necessitate additional charges to earnings.

At June 30, 2011 the Bank had \$29.8 million of classified loans and \$10.9 million of loans on non-accrual. This compares to \$47.6 million of classified loans and \$17.9 million of loans on non-accrual at December 31, 2010.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Interest income that would have been recorded	\$ 183	\$ 232	\$ 356	\$ 461
Interest income recorded	-	-	5	-
Effect on interest income	<u>\$ 183</u>	<u>\$ 232</u>	<u>\$ 351</u>	<u>\$ 461</u>

Impaired Loans

Impaired loans generally include loans which management believes it is probable that the Bank will not be able to collect all amounts due in accordance with the terms of the loan agreement and which are analyzed for a specific reserve allowance. The Bank generally considers loans risk-graded substandard and doubtful, as well as non-accrual and certain restructured loans, as impaired loans.

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

	June 30, 2011		December 31, 2010	
	Recorded Investment	Valuation Allowance	Recorded Investment	Valuation Allowance
Valuation allowance required	\$ 10,852	\$ 2,173	\$ 17,819	\$ 2,710
No valuation allowance required	2,239	-	43	-
Total impaired loans	<u>\$ 13,091</u>	<u>\$ 2,173</u>	<u>\$ 17,862</u>	<u>\$ 2,710</u>

The valuation allowance on impaired loans is included in the Bank's allowance for credit losses. The average recorded investment in impaired loans as of the dates indicated, and approximate interest income recognized for such loans for the periods indicated, were as follows (dollars are in thousands):

	June 30, 2011		June 30, 2010	
	Average recorded investment in impaired loans	\$ 14,371	\$ 40,795	
Average recorded investment in impaired loans as a percentage of average total loans	3.81%	7.42%		
	Three Months Ended June 30, 2011		Three Months Ended June 30, 2010	
Interest income recognized on impaired loans	\$ -	\$ 51		
Interest income recognized on a cash basis during the time of impairment	\$ -	\$ -		
	Six Months Ended June 30, 2011		Six Months Ended June 30, 2010	
Interest income recognized on impaired loans	\$ 5	\$ 51		
Interest income recognized on a cash basis during the time of impairment	\$ -	\$ -		

Cash receipts on impaired loans that are on non-accrual are applied to principal. Cash receipts on restructured loans included in impaired loans are recognized in accordance with the restructured terms. Interest income on impaired loans is recognized on an accrual basis only when the loan is considered to be well collateralized and payments are being received as we currently expect even though expectations are other than the original contractual terms.

Restructured Loans

Restructured loans are loans for which concessions, including a reduced interest rate or a deferral of interest or principal, have been granted due to the borrower's weakened financial condition. Once a loan is restructured, interest is accrued at the restructured rates when no loss of principal is anticipated. A loan that has performed in accordance with restructured terms for one year is no longer reported as a restructured loan. We had restructured loans aggregating \$14.1 million at June 30, 2011 and \$34.3 million at December 31, 2010.

Potential Problem Loans

So long as challenging economic conditions and deflationary pressures persist, many loans are potentially problematic.

We attempt to quantify potential problem loans with more immediate exposure and at June 30, 2011 such loans totaled \$47 thousand compared to \$12.4 million at December 31, 2010. A significant portion of these potential problem loans are not in default but may have characteristics such as recent adverse operating cash flows or general risk characteristics that the loan officer feels might jeopardize the future timely collection of principal and interest payments. The ultimate resolution of these credits is subject to changes in economic conditions and other factors. These loans are closely monitored to ensure that our position as creditor is protected to the fullest extent possible.

Other Real Estate

See Note 6 included in the quarterly report.

Liabilities

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

Liabilities	June 30,	December 31,	Increase (Decrease)		
	2011	2010	\$	%	
Deposits:					
Non-interest-bearing	\$ 92,538	\$ 91,478	\$	1	% (a)
Interest-bearing-					
Savings, interest checking and money market	250,489	243,332	7,157	3	% (a)
Time deposits \$100,000 and over	70,185	83,490	(13,305)	(16)	%
Time deposits under \$100,000	136,093	135,365	728	1	% (b)
Non-interest-bearing held for sale	-	34,610	(34,610)	(100)	% (c)
Interest-bearing held for sale	-	72,836	(72,836)	(100)	% (c)
Short-term borrowings	13,852	16,329	(2,477)	(15)	%
FHLB advances	-	-	-	-	%
Other borrowings	-	-	-	-	%
Guaranteed preferred beneficial interests in Company's subordinated debentures	22,426	22,425	1	-	%
Accrued interest payable	3,187	2,561	626	24	%
Accrued expenses	4,635	4,704	(69)	1	%
Other liabilities	2,349	2,618	(269)	(10)	%
Total liabilities	\$ 595,754	\$ 709,748	\$ (113,994)	(16)	%

- (a) These types of accounts can fluctuate significantly due to the cash management activities of our customers, particularly our commercial customers.
- (b) Efforts to reduce the cost of funds have resulted in declining balances of certificates.
- (c) These balances decreased when the branch divestiture was consummated.

Stockholders' Equity

Our stockholders' equity decreased \$42 thousand between December 31, 2010 and June 30, 2011 primarily due to changes in unrealized gains and losses in our investment portfolio.

Liquidity Risk Management

Liquidity risk is the possibility of being unable to meet all present and future financial obligations in a timely manner. Liquidity risk management encompasses our ability to meet all present and future financial obligations in a timely manner. The objectives of liquidity management policies are to maintain adequate liquid assets, liability diversification among instruments, maturities and customers and a presence in both the wholesale purchased funds market and the retail deposit market.

The Consolidated Statements of Cash Flows in the Consolidated Financial Statements present data on cash and cash equivalents provided by and used in operating, investing and financing activities. In addition to liquidity from core deposit growth, together with repayments and maturities of loans and investments, we utilize brokered deposits, sell securities under agreements to repurchase and borrow overnight Federal funds. The Bank is a member of the FHLB of Des Moines. Advances from the FHLB are collateralized by the Bank's mortgage loans and various investment securities. We have also obtained funding through the issuance of subordinated notes, subordinated debentures and long-term borrowings.

Our liquidity is measured by our ability to meet our cash and collateral obligations at a reasonable cost and with a minimum loss of income. Given the uncertain nature of our customers' demands as well as our desire to take advantage of earnings enhancement opportunities, we must have adequate sources of on- and off-balance-sheet funds that can be acquired in time of need.

We measure our liquidity position on an ongoing basis. Key factors that determine our liquidity are the reliability or stability of our deposit base, the pledged/non-pledged status of our investments and potential loan demand. Our liquidity management system divides the balance sheet into liquid assets and short-term liabilities that are assumed to be vulnerable to non-replacement under abnormally stringent conditions. The excess of liquid assets over short-term liabilities is measured over a 30-day planning horizon. Assumptions for short-term liabilities vulnerable to non-replacement under abnormally stringent conditions are based on a historical analysis of the month-to-month percentage changes in deposits. The excess of liquid assets over short-term liabilities and other key factors such as expected loan demand as well as access to other sources of liquidity such as lines with the FHLB, Federal funds and those other supplemental sources listed above are tied together to provide a measure of our liquidity. We have a targeted range and manage our operations such that these targets can be achieved. We believe that our prudent management policies and guidelines will ensure adequate levels of liquidity to fund anticipated needs of on- and off-balance-sheet items. In addition, a contingency funding policy statement identifies actions to be taken in response to an adverse liquidity event, and identifies potential funding needs and funding sources under various "stressed scenarios."

Available borrowing capacity from the FHLB was approximately \$56.6 million as of June 30, 2011.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Interest rate risk arises from changes in interest rates. Interest rate risk can result from: (1) Repricing risk – timing differences in the maturity/repricing of assets, liabilities, and off-balance-sheet contracts; (2) Options risk – the effect of embedded options, such as loan prepayments, interest rate caps/floors, and deposit withdrawals; (3) Basis risk – risk resulting from unexpected changes in the spread between two or more different rates of similar maturity, and the resulting impact on the behavior of lending and funding rates; and (4) Yield curve risk – risk resulting from unexpected changes in the spread between two or more rates of different maturities from the same type of instrument. We have risk management policies to monitor and limit exposure to interest rate risk. To date we have not conducted trading activities as a means of managing interest rate risk. Our asset/liability management process is utilized to manage our interest rate risk. The measurement of interest rate risk associated with financial instruments is meaningful only when all related and offsetting on- and off-balance-sheet transactions are aggregated, and the resulting net positions are identified.

Our interest rate risk exposure is actively managed with the objective of managing the level and potential volatility of net interest income in addition to the long-term growth of equity, bearing in mind that we will always be in the business of taking on rate risk and that rate risk immunization is not entirely possible. Also, it is recognized that as exposure to interest rate risk is reduced, so too may the overall level of net interest income and equity. In general, the assets and liabilities generated through ordinary business activities do not naturally create offsetting positions with respect to repricing or maturity characteristics. Access to the derivatives market can be an important element in maintaining our interest rate risk position within policy guidelines. Using derivative instruments, principally interest rate floors, caps, and interest rate swaps, the interest rate sensitivity of specific transactions, as well as pools of assets or liabilities, can be adjusted to maintain the desired interest rate risk profile.

Our primary tool for measuring and managing interest rate risk is net interest income simulation. This exercise includes our assumptions regarding the changes in interest rates and the impact on our current balance sheet. Interest rate caps and floors are included to the extent that they are exercised in the 12-month simulation period. Additionally, changes in prepayment behavior of the residential mortgage, CMOs, and mortgage-backed securities portfolios in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. For purposes of this simulation, projected month end balances of the various balance sheet accounts are held constant at their June 30, 2011 levels. Cash flows from a given account are reinvested back into the same account so as to keep the month end balance constant at its June 30, 2011 level. The static balance sheet assumption is made so as to project the interest rate risk to net interest income embedded in the existing balance sheet. With knowledge of the balance sheet's existing net interest income profile, more informed strategies and tactics may be developed as it relates to the structure/mix of growth.

We monitor the results of net interest income simulation on a regular basis. Net interest income is generally simulated for the upcoming 12-month horizon in seven interest rate scenarios. The scenarios generally modeled are parallel interest rate ramps of +/- 100bp, 200bp, and 300bp along with a rates unchanged scenario. Given the current low absolute level of interest rates as of June 30, 2011, the downward scenarios for interest rate movements is limited to -100bp but a +400bp scenario has been added. The parallel movement of interest rates means all projected market interest rates move up or down by the same amount. A ramp in interest rates means that the projected change in market interest rates occurs over the 12-month horizon on a pro-rata basis. For example, in the +100bp scenario, the projected Prime rate is projected to increase from 3.25% to 4.25% 12 months later. The Prime rate in this example will increase 1/12th of the overall increase of 100 basis points each month.

The net interest income simulation results for the 12-month horizon are shown below (dollars are in thousands):

Net Interest Income Simulation						
Movement in interest rates	<u>-100bp</u>	<u>Unchanged</u>	<u>+100bp</u>	<u>+200bp</u>	<u>+300bp</u>	<u>+400bp</u>
Projected 12-month net interest income	\$ 18,925	\$ 19,535	\$ 20,085	\$ 19,887	\$ 19,479	\$ 19,030
Dollar change from unchanged scenario	\$ (610)	-	\$ 550	\$ 352	\$ (56)	\$ (505)
Percentage change from unchanged scenario	-3.12%	-	2.82%	1.80%	-0.29%	-2.59%

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of June 30, 2011 (without forward adjustments for planned growth and anticipated business activities) and do not contemplate any actions we might undertake in response to changes in market interest rates.

Static gap analysis is another tool that may be used for interest rate risk measurement. The net differences between the amount of assets, liabilities, equity and off-balance-sheet instruments repricing within a cumulative calendar period is typically referred to as the “rate sensitivity position” or “gap position.” The following table sets forth our rate sensitivity position as of June 30, 2011. Assets and liabilities are classified by the earliest possible repricing date or maturity, whichever occurs first.

Interest Sensitivity Gap Analysis

Estimated maturity or repricing at June 30, 2011

	0-3 months	4-12 Months	1-5 Years	Over 5 years	Total
(dollars are in thousands)					
Interest-earning assets:					
Interest-bearing deposits with banks	\$ 26,379	\$ -	\$ -	\$ -	\$ 26,379
Investment securities (a)	7,354	23,103	115,460	64,201	210,118
FRB and FHLB stock	2,697	-	-	-	2,697
Fed funds sold	-	-	-	-	-
Loans held for sale-mortgage banking, fixed rate	-	30,269	-	-	30,269
Loans held for sale-mortgage banking, floating rate	-	-	-	-	-
Loans held for investment, fixed rate	37,445	44,494	82,526	16,519	180,984
Loans held for investment, floating rate	117,367	2,299	12,432	-	132,098
Total interest-earning assets	<u>\$ 191,242</u>	<u>\$ 100,165</u>	<u>\$ 210,418</u>	<u>\$ 80,720</u>	<u>\$ 582,545</u>
Interest-bearing liabilities:					
Interest checking and money market accounts	\$ 238,392	\$ -	\$ -	\$ -	\$ 238,392
Savings	12,097	-	-	-	12,097
Time deposits under \$100,000	20,912	37,845	37,129	40,207	136,093
Time deposits \$100,000 and over	18,490	41,795	9,900	-	70,185
Short-term borrowings	13,852	-	-	-	13,852
FHLB advances	-	-	-	-	-
Other borrowing	-	-	-	-	-
Subordinated debentures	15,000	-	-	7,426	22,426
Total interest-bearing liabilities	<u>\$ 318,743</u>	<u>\$ 79,640</u>	<u>\$ 47,029</u>	<u>\$ 47,633</u>	<u>\$ 493,045</u>
Interest rate gap	<u>\$ (127,501)</u>	<u>\$ 20,525</u>	<u>\$ 163,389</u>	<u>\$ 30,713</u>	<u>\$ 87,126</u>
Cumulative interest rate gap at June 30, 2011	<u>\$ (127,501)</u>	<u>\$ (106,976)</u>	<u>\$ 56,413</u>	<u>\$ 87,126</u>	
Cumulative interest rate gap to total assets	(20.14)%	(16.90)%	8.91%	13.76%	

(a) Cash flows from securities are less than the fair value amount on the balance sheet due to the securities net unamortized premiums of \$10.380 million.

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

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

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of June 30, 2011 and do not contemplate any actions we might undertake in response to changes in market interest rates.

Other Information

Item 1. Legal Proceedings

From time to time, we may be a party to legal proceedings arising out of our lending, deposit operations or other activities. We engage in foreclosure proceedings and other collection actions as part of our loan collection activities. From time to time, borrowers may also bring actions against us, in some cases claiming damages. Some financial services companies have been subjected to significant exposure in connection with litigation, including class action litigation and punitive damage claims. While we are not aware of any such actions or allegations that should reasonably give rise to any material adverse effect, it is possible that we could be subjected to such a claim in an amount that could be material. Based upon a review with our legal counsel, we believe that the ultimate disposition of such pending litigation will not have a material effect on our financial condition, results of operations or cash flows.

We have asserted claims against our insurance carriers as described in Note 4.

Signatures

This report is submitted on behalf of the Company by the duly authorized undersigned.

BNCCORP, INC.

Date: August 9, 2011

By: /s/ Gregory K. Cleveland
Gregory K. Cleveland
President and Chief Executive Officer

By: /s/ Timothy J. Franz
Timothy J. Franz
Chief Financial Officer