SOUTHEASTERN BANKING CORP
Form 10-K
March 30, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2011

Commission File Number 000-32627

(Exact name of registrant as specified in its charter)

Georgia	**58-1423423**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

P. O. Box 455, 1010 North Way, Darien, Georgia 31305

(Address of principal executive offices) (Zip Code)

(912) 437-4141

(Registrant s telephone number, including area code)

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value $1.25 per share

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

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

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

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

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

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

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

The aggregate market value of common stock held by non-affiliates on June 30, 2011 was approximately $12,421,000 (based on a per share price of $6.05 on over-the-counter trades executed by broker-dealers). For purposes of this calculation, the Registrant has assumed that its directors, principal shareholders and executive officers are affiliates.

As of March 1, 2012, the Registrant had 3,129,388 shares of common stock, par value $1.25 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive Proxy Statement in connection with the 2012 Annual Meeting of Shareholders are incorporated by reference into Part III of this Report.

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CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements set forth in this Report or incorporated herein by reference, including, without limitation, matters discussed under the caption *Management s Discussion and Analysis of Financial Condition and Results of Operations* are forward-looking statements within the meaning of the federal securities laws, including, without limitation, statements regarding our outlook on earnings, stock performance, asset quality, economic conditions, real estate markets and projected growth, and are based upon management s beliefs as well as assumptions made based on data currently available to management. In this Report, the terms the Company , the Bank , we , us , or our refer to Southeastern Banking Corporation and its wholly-owned subsidiaries, Southeastern Bank and SBC Financial Services, Inc. When words like anticipate , believe , intend , plan , may , continue , project , would , expect , estimate , could , should , will , and similar expressions are used, you should consid identifying forward-looking statements. These forward-looking statements are not guarantees of future performance, and a variety of factors could cause our actual results to differ materially from the anticipated or expected results expressed in these forward-looking statements. Many of these factors are beyond our ability to control or predict, and readers are cautioned not to put undue reliance on such forward-looking statements. The following list, which is not intended to be an all-encompassing list of risks and uncertainties affecting us, summarizes several factors that could cause our actual results to differ materially from those anticipated or expected in these forward-looking statements: (1) general economic conditions (both generally and in our markets) may be less favorable than expected, resulting in, among other things, a continued deterioration in credit quality, a further reduction in demand for credit and/or a further decline in real estate values; (2) the general decline in the real estate and lending market, particularly the market areas of Coastal Georgia and North Florida, may continue to negatively affect our financial results; (3) our ability to raise additional capital may be impaired if current levels of market disruption and volatility continue or worsen; (4) restrictions or conditions imposed by our regulators on our operations may make it more difficult for us to achieve our goals; (5) legislative or regulatory changes, including changes in accounting standards and compliance requirements, may adversely affect the businesses in which we are engaged; (6) competitive pressures among depository and other financial institutions may increase significantly; (7) changes in the interest rate environment may reduce margins or the volumes or values of the loans we make; (8) competitors may have greater financial resources and develop products that enable those competitors to compete more successfully than we can; (9) our ability to attract and retain key personnel can be affected by the increased competition for experienced employees in the banking industry; (10) adverse changes may occur in the bond and equity markets; (11) war or terrorist activities may cause further deterioration in the economy or cause instability in credit markets; and (12) the risk factors discussed from time to time in the Company s Periodic Reports filed with the Securities and Exchange Commission (the SEC), including but not limited to, this Annual Report on Form 10-K (the Report). We undertake no obligation to, and we do not intend to, update or revise these statements following the date of this filing, whether as a result of new information, future events or otherwise, except as may be required by law. All written or oral forward-looking statements attributable to us are expressly qualified in their entirety by this Cautionary Notice. Our actual results may differ significantly from those we discuss in these forward-looking statements. For other factors, risks and uncertainties that could cause our actual results to differ materially from estimates and projections contained in these forward-looking statements, please read the Risk Factors section of this report. Any forward-looking statement speaks only as of the date that the statement was made, and, except as required by law, we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect events or circumstances after the date on which we made the statement or to reflect the occurrence of unanticipated events.

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PART I

ITEM 1. BUSINESS
General

Southeastern Banking Corporation (the Company) is a bank holding company headquartered in Darien, McIntosh County, Georgia. The Company was organized and incorporated in 1980 under the laws of the State of Georgia as the holding company for its then sole subsidiary bank, The Citizens Bank, Folkston, Georgia, which later changed its name to Southeastern Bank (the Bank). In 1983, the Company acquired The Darien Bank, Darien, Georgia, one of the oldest banks in the state, with a banking charter dating back to 1888. From 1983 to 1988, the Company acquired three other Georgia financial institutions and subsequently merged those institutions into the Bank. In 1990, the Bank merged with and into The Darien Bank, with the Darien Bank being the surviving bank in the merger operating under its 1888 charter. Immediately upon the merger, The Darien Bank changed its name to Southeastern Bank.

Currently, the Bank operates 13 branches located in eight counties in southeast Georgia and three branches located in one county in northeast Florida. Additional information on each of the markets that we serve is provided below under the caption *Markets and Competition.*

Unless the context indicates otherwise, all references in this report to the Company, we, us and our refer to Southeastern Banking Corporation and its wholly owned subsidiaries, Southeastern Bank and SBC Financial Services, Inc., except that in the discussion of its capital stock and related matters, these terms refer solely to Southeastern Banking Corporation and not to its subsidiaries. All references to the Bank refer to Southeastern Bank only.

The Bank

The Bank offers traditional banking products and services to commercial and individual customers in our markets. Our product line includes, among other things, loans to small- and medium-sized businesses, residential and commercial construction and development loans, commercial real estate loans, farmland and agricultural production loans, residential mortgage loans, home equity loans, consumer loans, and a variety of commercial and consumer demand, savings and time deposit products. We also offer internet banking, on-line cash management, electronic bill payment services, safe deposit box rentals, telephone banking, credit and debit card services, remote depository products and the availability of a network of automated teller machines (ATMs) to our customers. In addition, through an agreement with a third-party broker-dealer and investment advisory firm, we are able to offer securities brokerage and investment advisory services to our customers.

Markets and Competition

The financial services industry is highly competitive. In our markets, we face competitive pressures from both larger regional banks and smaller community banks and thrifts in attracting and retaining commercial and consumer accounts. The competitive environment is amplified in some of our smaller markets as there are more financial service providers competing for fewer customers. The principal factors in competing for such accounts include interest rates, fee structures, the range of products and services offered, convenience of office and ATM locations, and flexible office hours. Other competition for such accounts comes from credit unions, internet banks, retail brokerage firms, mortgage companies, insurance companies and consumer finance offices. These nonbank financial providers are not subject to the same regulatory restrictions as banks and bank holding companies. Therefore, they can often operate at a competitive advantage with greater flexibility, lower cost structures and higher leverage. Other investment alternatives such as stocks and mutual funds made readily accessible by the internet have also had an effect on our ability to grow deposits in our markets.

Our experience and strong community relationships in our markets allow us to deliver a higher level of customer service to the small- and medium-sized commercial businesses and to individual consumers. Being smaller and less bureaucratic than our regional and national competitors allows us to provide a more timely response and greater flexibility in serving the needs of our customers. At the same time, we have invested in systems and support to provide a product line that we believe gives us a competitive edge over many of the smaller financial institutions in our markets.

A brief description of each of our markets follows.

Georgia

The Bank has branches in thirteen communities in eight counties in southeast Georgia. Overall, we have the third largest market share[1] with 8.70% of the total deposits in the Bank s eight-county Georgia market.

McIntosh County is located on the Georgia coast along Interstate 95. Darien is the county seat of McIntosh County and is 62 miles south of Savannah, 17 miles north of Brunswick and 79 miles north of Jacksonville, Florida. McIntosh County is part of the Brunswick Metropolitan Statistical Area (MSA). We have 16 employees, two branches (Darien and Eulonia), and an ATM serving our customers in this county. The Company s administrative and operational facilities and 40 additional employees are also located in Darien. Founded in 1793, McIntosh County is one of the oldest counties in Georgia. The county is rich in historical sites and nature preserves. McIntosh County contains Harris Neck National Wildlife Refuge, Blackbeard Island National Wildlife Refuge and Wilderness Area, Fort King George State Historic Site, Wolf Island National Wildlife Refuge and Wilderness, Sapelo Island State Reserve and Sapelo Island National Estuarine Sanctuary.

Brantley County is southwest of McIntosh County. Brantley County is part of the Brunswick MSA. The Bank has a branch in Nahunta (the county seat) and in Hoboken. Nahunta is 40 miles southwest of Darien and Hoboken is 9 miles west of Nahunta along U.S. Highway 82. We have 16 employees, two branches and an ATM serving our customers in this county. The Okefenokee National Wildlife Refuge, an approximate 700 acre freshwater and black water wilderness swamp, occupies parts of the County s southern and western borders.

Bryan County is north of McIntosh County. Bryan County is part of the Savannah MSA. The Bank has one branch in Richmond Hill. Richmond Hill is 43 miles north of Darien along Interstate 95 and 22 miles west of Savannah along Interstate 16. We have five employees, one branch and an ATM serving our customers in this county. Fort Stewart, a large U.S. Army training facility, runs through Bryan County.

Camden County is south of McIntosh County. Camden County is part of the St. Marys MSA. The Bank has branches in Woodbine (the county seat), Kingsland and St. Marys. Woodbine is 37 miles south of Darien, Kingsland is 47 miles south of Darien and St. Marys is 52 miles south of Darien. We have 13 employees, three branches and three ATMs serving our customers in this county. Camden County is home to Kings Bay Naval Nuclear Submarine Base and the Cumberland Island National Seashore.

Charlton County is southwest of McIntosh County. The Bank has a branch in Folkston (the county seat). Folkston is 59 miles southwest of Darien and 20 miles west of Kingsland. We have eight employees, a branch and an ATM serving our customers in this county. The Okefenokee National Wildlife Refuge occupies approximately one-third of the county.

Coffee County is west of McIntosh County. Coffee County is part of the Douglas MSA. The Bank has branches in Douglas (the county seat) and Nicholls. Douglas is 96 miles west of Darien and Nicholls is 83 miles west of Darien. We have ten employees, two branches and two ATMs serving our customers in this county.

Glynn County is south of McIntosh County. Glynn County is part of the Brunswick MSA. The Bank has a branch in Brunswick, the county seat. Brunswick is 17 miles south of Darien along Interstate 95. We have nine employees, one branch and an ATM serving our customers in this county. We also have ten administrative and executive employees located in the Brunswick branch facility. With its marshlands and barrier islands, this area referred to as the Golden Isles is a major tourist and recreational center. Glynn County is home to the Federal Law Enforcement Training Center, an interagency law enforcement training organization for 90 federal agencies and various other state, local and international law enforcement agencies, and the Georgia Port Authority s Port of Brunswick, one of the largest deepwater port operations in the U.S. South Atlantic.

Jeff Davis County is west of McIntosh County. The Bank has a branch in Hazlehurst, the county seat. Hazlehurst is 88 miles west of Darien and 31 miles northeast of Douglas. We have five employees, a branch and an ATM serving our customers in this county.

[1] Based on the FDIC Summary of Deposits report as of June 30, 2011.

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Florida

The Bank has three branches in one county in the northeast corner of Florida. We have the fifth largest market share[2] with 7.55% of the total deposits in the Bank s Florida market.

Nassau County is south of McIntosh County. Nassau County is part of the Jacksonville MSA. The Bank has branches in Callahan, Hilliard and Yulee (the county seat). Yulee is 58 miles south of Darien and 24 miles north of Jacksonville along Interstate 95. Hilliard is 69 miles southwest of Darien and 10 miles south of Folkston. Callahan is 70 miles south of Darien and 15 miles west of Yulee. We have 16 employees, three branches and three ATMs serving our customers in this county.

Market Demographics

The Bank operates mainly in rural, slower growth markets. It also has a growing presence in some more heavily-populated coastal markets. The following table provides the most current summary demographic data[3] on each of our markets.

Market/ County	2010 Population	2000-10 % Change Population	Persons per Square Mile	2009 Private Nonfarm Employment	2000-09 % Change Employment	2010 Median Household Income	2010 % Persons Below Poverty Level
Georgia							
McIntosh	14,333	32.1	33.8	1,435	-29.2	$ 39,075	16.6
Brantley	18,411	25.9	41.6	1,297	-11.3	$ 37,343	21.4
Bryan	30,233	29.1	69.3	5,710	81.2	$ 63,244	11.0
Camden	50,513	15.7	82.4	8,658	7.3	$ 49,230	15.3
Charlton	12,171	18.4	15.7	1,716	7.2	$ 40,850	19.8
Coffee	42,356	13.2	73.7	12,779	-24.3	$ 35,202	21.3
Glynn	79,626	17.8	189.7	31,508	3.1	$ 50,337	15.2
Jeff Davis	15,068	18.8	45.6	3,444	-25.2	$ 32,928	24.0
GA Statewide	9,687,653	18.3	168.4	3,410,505	-2.1	$ 49,347	15.7
Florida							
Nassau	73,314	27.1	113.0	14,525	13.9	$ 58,712	9.3
FL Statewide	18,801,310	17.6	350.6	6,861,612	10.4	$ 47,661	13.8

Market Presence

The following table provides basic summary information on the Bank s presence in each of our markets.

Market/ County	Metropolitan Statistical Area	Number of Branches	Number of ATMs	Number of Employees	Total Loans[4]	Total Deposits[4]	Market Share (%)[2]	Market Share Rank[2]
Georgia								
McIntosh	Brunswick	2	1	56[5]	$ 57,320	$ 62,510	72.01	1
Brantley	Brunswick	2	1	16	16,911	57,127	70.80	1
Bryan	Savannah	1	1	5	21,940	6,481	1.78	5
Camden	St. Marys	3	3	13	27,349	60,804	19.74	2
Charlton	n/a	1	1	8	2,888	56,023	55.28	1
Coffee	Douglas	2	2	10	9,178	20,474	3.22	9
Glynn	Brunswick	1	1	19[5]	42,276	17,950	1.16	15
Jeff Davis	n/a	1	1	5	3,214	20,749	17.04	3
Total in GA		13	11	132	$ 181,076	$ 302,118	0.17	54

Florida								
Nassau	Jacksonville	3	3	16	$ 21,187	$ 67,754	7.55	5
Total in FL		3	3	16	$ 21,187	$ 67,754	0.02	269
Company Total		16	14	148	$ 202,263	$ 369,872		

[2] Based on the FDIC Summary of Deposits report as of June 30, 2011.
[3] Source: U.S. Census Bureau, www.census.gov.
[4] Dollar amounts are presented in thousands as of December 31, 2011.
[5] Includes administrative and operational support employees: 40 in McIntosh County and 10 in Glynn County.

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Employees

As of December 31, 2011, we had a total of 142 full-time and six part-time employees. We offer a competitive compensation and benefits package to our employees, and we consider our relationship with our employees to be good.

Availability of Information

More information on the Company is available through a link on our internet website at *www.southeasternbank.com*. We are not incorporating by reference into this Report the information contained on our website and, therefore, the content of our website is not a part of this Report. Copies of this Report and other reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, including exhibits, are available free of charge on our website under the About tab as soon as reasonably practicable after they have been filed or furnished electronically to the SEC. Copies of these filings may also be obtained free of charge on the SEC s website at *www.sec.gov*.

Supervision and Regulation

Both federal and state laws extensively regulate bank holding companies and banks. These laws (and the regulations promulgated thereunder) are primarily intended to protect depositors and the deposit insurance fund of the Federal Deposit Insurance Corporation (the FDIC). The following information describes particular laws and regulatory provisions relating to bank holding companies and banks. This discussion is qualified in its entirety by reference to the particular laws and regulatory provisions. A change in any of these laws or regulations may have a material effect on our business and the business of the Bank.

General

The Company is a bank holding company registered with the Board of Governors of the Federal Reserve System (the Federal Reserve) and the Georgia Department of Banking and Finance (the Georgia Department) under the Bank Holding Company Act of 1956, as amended (the BHC Act) and the Financial Institutions Code of Georgia, respectively. The Company is subject to regulation, supervision, and examination by the Federal Reserve and the Georgia Department. The Federal Reserve may also make examinations of each of the Company s subsidiaries.

The Bank is a Georgia-chartered commercial bank. The Bank is a member of the FDIC, and as such, our deposits are insured by the FDIC to the maximum extent provided by law. The Bank is subject to regulation, supervision, and examination by the FDIC and the Georgia Department. These regulatory agencies regularly examine our operations and are given authority to approve or disapprove mergers, consolidations, the establishment of branches, and similar corporate actions. The agencies also have the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law.

Dodd-Frank Act

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was signed into law. The Dodd-Frank Act is intended to effect a fundamental restructuring of federal banking regulation. Among other things, the Dodd-Frank Act creates a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms. The Dodd-Frank Act additionally creates a new independent federal regulator to administer federal consumer protection laws. The enacted provisions of the Dodd-Frank Act has already made an impact on our business operations through increased compliance and operating costs, increased deposit insurance and decreased fee income. It is difficult to predict at this time what specific impact the yet-to-be written implementing rules and regulations of the Dodd-Frank Act will have on community banks. A summary of a few of the provisions of the Dodd-Frank Act follow.

Payment of Interest on Business Checking Accounts. Effective one year from the date of enactment, the Dodd-Frank Act eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

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Corporate Governance. The Dodd-Frank Act requires publicly-traded companies to give stockholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called golden parachute payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders. The new legislation also authorizes the SEC to promulgate rules that would allow stockholders to nominate their own candidates using a company s proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the company is publicly traded or not. The Dodd-Frank Act gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Prohibition Against Charter Conversions of Troubled Institutions. Effective one year after enactment, the Dodd-Frank Act prohibits a depository institution from converting from a state to federal charter or vice versa while it is the subject of a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter unless the appropriate federal banking agency gives notice of the conversion to the federal or state authority that issued the enforcement action and that agency does not object within 30 days. The notice must include a plan to address the significant supervisory matter. The converting institution must also file a copy of the conversion application with its current federal regulator which must notify the resulting federal regulator of any ongoing supervisory or investigative proceedings that are likely to result in an enforcement action and provide access to all supervisory and investigative information relating thereto.

Limits on Derivatives. Effective 18 months after enactment, the Dodd-Frank Act prohibits state-chartered banks from engaging in derivatives transactions unless the loans to one borrower limits of the state in which the bank is chartered takes into consideration credit exposure to derivatives transactions. For this purpose, derivative transaction includes any contract, agreement, swap, warrant, note or option that is based in whole or in part on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodities securities, currencies, interest or other rates, indices or other assets.

Debit Card Interchange Fees. Effective July 21, 2011, the Dodd-Frank Act requires that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by the issuer. On June 29, 2011, the Federal Reserve set the interchange rate cap at $0.24 per transaction. While the restrictions on interchange fees do not apply to banks that, together with their affiliates, have assets of less than $10 billion, the rule could affect the competitiveness of debit cards issued by smaller banks.

Consumer Financial Protection Bureau. The Dodd-Frank Act creates a new, independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB will have examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower s ability to repay. In addition, the Dodd-Frank Act will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a qualified mortgage as defined by the CFPB. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

Acquisitions

The BHC Act requires every bank holding company to obtain the prior approval of the Federal Reserve before: (i) it may acquire direct or indirect ownership or control of any voting shares of any bank if, after such acquisition, the bank holding company will directly or indirectly own or control more than 5% of the voting shares of the bank; (ii) it or any of its subsidiaries, other than a bank, may acquire all or substantially all of the assets of any bank; or (iii) it may merge or consolidate with any other bank holding company.

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Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, and as further amended by the Dodd-Frank Act, the restrictions on interstate acquisitions of banks by bank holding companies were repealed. As a result, the Company, and any other bank holding company located in Georgia, is able to acquire a bank located in any other state, and a bank holding company located outside of Georgia can acquire any Georgia-based bank, in either case subject to certain deposit percentage concentration limits and other restrictions. De novo branching by an out-of-state bank is permitted only if it is expressly permitted by the laws of the host state. Georgia does not permit de novo branching by an out-of-state bank. Therefore, the only method by which an out-of-state bank or bank holding company may enter Georgia is through an acquisition.

Activities

The BHC Act has generally prohibited a bank holding company from engaging in activities other than banking or managing or controlling banks or other permissible subsidiaries and from acquiring or retaining direct or indirect control of any company engaged in any activities other than those determined by the Federal Reserve to be closely related to banking or managing or controlling banks as to be a proper incident thereto. Provisions of the Gramm-Leach-Bliley Act (the GLB Act), discussed below, have expanded the permissible activities of a bank holding company that qualifies as a financial holding company. In determining whether a particular activity is permissible, the Federal Reserve must consider whether the performance of such an activity can be reasonably expected to produce benefits to the public, such as a greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

Gramm-Leach-Bliley Act

The GLB Act implemented major changes to the statutory framework for providing banking and other financial services in the United States. The GLB Act, among other things, eliminated many of the restrictions on affiliations among banks and securities firms, insurance firms, and other financial service providers. A bank holding company that qualifies as a financial holding company is permitted to engage in activities that are financial in nature or incidental or complimentary to a financial activity. The GLB Act specifies certain activities that are deemed to be financial in nature, including underwriting and selling insurance, providing financial and investment advisory services, underwriting, dealing in, or making a market in securities, limited merchant banking activities, and any activity currently permitted for bank holding companies under Section 4(c)(8) of the BHC Act.

To become eligible for these expanded activities, a bank holding company must qualify as a financial holding company. To qualify as a financial holding company, each insured depository institution controlled by the bank holding company must be well-capitalized, well-managed, and have at least a satisfactory rating under the Community Reinvestment Act. In addition, the bank holding company must file a declaration with the Federal Reserve of its intention to become a financial holding company.

The GLB Act designates the Federal Reserve as the overall umbrella supervisor of financial holding companies. The GLB Act adopts a system of functional regulation where the primary regulator is determined by the nature of activity rather than the type of institution. Under this principle, securities activities are regulated by the SEC and other securities regulators, insurance activities by the state insurance authorities, and banking activities by the appropriate banking regulator. As a result, to the extent that we engage in non-banking activities permitted under the GLB Act, we will be subject to the regulatory authority of the SEC or state insurance authority, as applicable. We have not made an election to become a financial holding company.

Payment of Dividends

The Company is a legal entity separate and distinct from its subsidiaries. Its principal source of cash flow is dividends from the Bank. There are statutory and regulatory limitations on the payment of dividends from the Bank to the Company, as well as by the Company to its shareholders. Due to the elevated level of nonperforming assets and operating losses, the Company and the Bank must obtain prior written consent from our regulators prior to the payment of a dividend.

The federal banking agencies have indicated that paying dividends that deplete a depository institution s capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally pay dividends only out of current operating earnings.

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In addition, the Federal Reserve, through guidance reissued in February 2009, has supervisory policies and guidance that:

- may restrict the ability of a bank or financial services holding company from paying dividends on any class of capital stock or any other Tier 1 capital instrument if the holding company is not deemed to have a strong capital position,
- states that a holding company should reduce or eliminate dividends when
  - the holding company s net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends;
  - the holding company s prospective rate of earnings retention is not consistent with the holding company s capital needs and overall current and prospective financial condition; or
  - the holding company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios.
- requires that a holding company must inform the Federal Reserve in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the organization s capital structure. Declaring or paying a dividend in either circumstance could raise supervisory concerns.

In the current financial and economic environment, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. During 2009, we paid a total of $0.30 per share in cash dividends to our shareholders. Early in 2010, we paid a total of $0.13 per share in cash dividends to our shareholders. Later in 2010, we suspended our dividends until our operating performance improved and credit losses abated. We did not pay a dividend during 2011. We do not intend to pay a dividend in 2012 due to regulatory restrictions and continued pressure on earnings and capital.

Capital Adequacy

We are required to comply with the capital adequacy standards established by the federal banking agencies. There are two basic measures of capital adequacy for bank holding companies that have been promulgated by the Federal Reserve: a risk-based measure and a leverage measure. All applicable capital standards must be satisfied for a bank holding company to be considered in compliance.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items.

The minimum guideline for the ratio of Total Capital to risk-weighted assets (including certain off-balance-sheet items, such as standby letters of credit) is 8.0%. Total Capital consists of Tier 1 Capital, which is comprised of common stock, undivided profits, minority interests in the equity accounts of consolidated subsidiaries and non-cumulative perpetual preferred stock, less goodwill and certain other intangible assets, and Tier 2 Capital, which consists of subordinated debt, other preferred stock, and a limited amount of loan loss reserves. The minimum guideline for the ratio of Tier 1 Capital to risk-weighted assets (including certain off-balance-sheet items, such as standby letters of credit) is 4.0%. At December 31, 2011, our consolidated Total Capital Ratio and our Tier 1 Capital Ratio were 17.63% and 16.37%, respectively.

In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide for a minimum ratio (the Leverage Ratio) of Tier 1 Capital to average assets, less goodwill and certain other intangible assets, of 3.0% for bank holding companies that meet certain specified criteria, including those having the highest regulatory rating. All other bank holding companies generally are required to maintain a Leverage Ratio of at least 3.0%, plus an additional cushion of 100 to 200 basis points. Our consolidated

Leverage Ratio at December 31, 2011 was 9.70%. The guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the Federal Reserve has indicated that it will consider a tangible Tier 1 Capital Leverage Ratio (deducting all intangibles) and other indicators of capital strength in evaluating proposals for expansion or new activities.

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The Bank is subject to risk-based and leverage capital requirements adopted by its federal banking regulators, which are substantially similar to those adopted by the Federal Reserve for bank holding companies. Failure to meet capital guidelines could subject a bank or bank holding company to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on the taking of brokered deposits, and certain other restrictions on its business. As described below, substantial additional restrictions can be imposed upon FDIC-insured depository institutions that fail to meet applicable capital requirements. See *Prompt Corrective Action* .

The federal bank agencies continue to indicate their desire to raise capital requirements applicable to banking organizations beyond their current levels. In this regard, the Federal Reserve and the FDIC require regulators to consider interest rate risk (when the interest rate sensitivity of an institution s assets does not match the sensitivity of its liabilities or its off-balance-sheet position) in the evaluation of a bank s capital adequacy. The regulatory agencies have proposed a methodology for evaluating interest rate risk that would require banks with excessive interest rate risk exposure to hold additional amounts of capital against such exposures.

The Basel Committee on Banking Supervision has issued proposed reforms to international bank capital and liquidity regulation. In December 2010, the Basel Committee released its final framework for strengthening international capital and liquidity regulation (Basel III). Basel III, when implemented by the U.S. banking agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain more capital, with a greater emphasis on common equity. Implementation is presently scheduled to be phased in between 2013 and 2019, although it is possible that implementation may be delayed as a result of multiple factors including the current condition of the banking industry within the U.S. and abroad.

The Basel III final capital framework, among other things, (i) introduces as a new capital measure Common Equity Tier 1 (CET1), (ii) specifies that Tier 1 capital consists of CET1 and Additional Tier 1 capital instruments meeting specified requirements, (iii) defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expands the scope of the adjustments as compared to existing regulations.

When fully phased in, Basel III requires banks to maintain (i) as a newly adopted international standard, a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a capital conservation buffer of 2.5%; (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer; (iii) a minimum ratio of Total (Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0% plus the capital conservation buffer and (iv) as a newly adopted international standard, a minimum leverage ratio of 3%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

Basel III also provides for a countercyclical capital buffer, generally to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk that would be a CET1 add-on to the capital conservation buffer in the range of 0% to 2.5% when fully implemented. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) may face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The Basel III final framework provides for a number of new deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Implementation of the deductions and other adjustments to CET1 will begin on January 1, 2014 and will be phased-in over a five-year period (20% per year). The implementation of the capital conservation buffer will begin on January 1, 2016 at 0.625% and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

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The U.S. banking agencies have indicated that they expect to propose regulations implementing Basel III, with final adoption of implementing regulations in mid-2012. Notwithstanding its release of the Basel III framework as a final framework, the Basel Committee is considering further amendments to Basel III. In addition to Basel III, the Dodd-Frank Act requires or permits the federal banking agencies to adopt regulations affecting banking institutions capital requirements in a number of respects, including potentially more stringent capital requirements for systemically important financial institutions. Accordingly, the regulations ultimately applicable to us may be substantially different from the Basel III final framework as published in December 2010. Requirements to maintain higher levels of capital or liquid assets could adversely impact our net income and return on equity.

Support of Subsidiary Institutions

Under Federal Reserve policy, the Company is expected to act as a source of financial strength for, and to commit resources to support, the Bank. This support may be required at times when, absent such Federal Reserve policy, we may not be inclined to provide such support. In addition, any capital loans by a bank holding company to any of its banking subsidiaries are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company s bankruptcy, any commitment by a bank holding company to a federal bank regulatory agency to maintain the capital of a banking subsidiary will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Prompt Corrective Action

FDICIA established a system of prompt corrective action to resolve the problems of undercapitalized institutions. Under this system, the federal banking regulators have established five capital categories (well capitalized , adequately capitalized , undercapitalized , significantly undercapitalized and critically undercapitalized), and are required to take certain mandatory supervisory actions, and are authorized to take other discretionary actions, with respect to institutions in the three undercapitalized categories. The severity of the action will depend upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category.

An institution that is categorized as undercapitalized , significantly undercapitalized , or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to certain limitations. The controlling holding company s obligation to fund a capital restoration plan is limited to the lesser of 5.0% of an undercapitalized subsidiary s assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. In addition, the appropriate federal banking agency may treat an undercapitalized institution in the same manner as it treats a significantly undercapitalized institution if it determines those actions are necessary.

At December 31, 2011, the Bank had the requisite capital level to qualify as well capitalized under the regulatory framework for prompt corrective action.

FDIC Insurance Assessments

The FDIC maintains a risk-based assessment system for determining deposit insurance premiums. Four risk categories (I-IV), each subject to different premium rates, are established, based upon an institution s capital category (discussed above) and the institution s supervisory rating. The levels of rates are subject to periodic adjustment by the FDIC. Additionally, the FDIC may impose special assessments from time to time.

The Dodd-Frank Act permanently increased the maximum deposit insurance amount for banks, savings institutions and credit unions to $250,000 per depositor, and extended unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2012. The Dodd-Frank Act also broadened the base for FDIC insurance assessments. Assessments are now based on a financial institution s average consolidated total assets less tangible equity capital. The Dodd-Frank Act also requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds.

There are three adjustments that can be made to an institution s initial base assessment rate: (1) a potential decrease for long-term unsecured debt, including senior and subordinated debt and, for small institutions, a portion of Tier 1 capital; (2) a potential increase for secured liabilities above a threshold amount; and (3) for non-Risk Category I institutions, a potential increase for brokered deposits above a threshold amount.

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The current schedule for base assessment rates and potential adjustment is set forth in the following table.

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV	Large and Highly Complex Institutions
Initial Base Assessment Rate	5 to 9	14	23	35	5 to 35
Unsecured Debt Adjustment (added)	(4.5) to 0	(5) to 0	(5) to 0	(5) to 0	(5) to 0
Brokered Deposit Adjustment (added)	N/A	0 to 10	0 to 10	0 to 10	0 to 10
Total Base Assessment Rate	2.5 to 9	9 to 24	18 to 33	30 to 45	2.5 to 45

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Safety and Soundness Standards

The Federal Deposit Insurance Act, as amended by the FDICIA and the Riegle Community Development and Regulatory Improvement Act of 1994, requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. The federal bank regulatory agencies have adopted a set of guidelines prescribing safety and soundness standards pursuant to FDICIA, as amended. The guidelines establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation and fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the prompt corrective action provisions of FDICIA. See *Prompt Corrective Action*. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties. The federal regulatory agencies also proposed guidelines for asset quality and earnings standards.

Community Reinvestment Act

Under the Community Reinvestment Act (CRA) the Bank, as an FDIC insured institution, has a continuing and affirmative obligation to help meet the credit needs of the entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA requires the appropriate federal regulator, in connection with its examination of an insured institution, to assess the institution s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications, such as applications for a merger or the establishment of a branch. An unsatisfactory rating may be used as the basis for the denial of an application by the federal banking regulator. The Bank received satisfactory ratings in its most recent CRA examination.

Restrictions on Transactions with Affiliates

The Company and the Bank are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on: the amount of a bank s loans or extensions of credit to affiliates; a bank s investment in affiliates; assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve; the amount of loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates; and a bank s guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10.0% of a bank s capital and surplus and, as to all affiliates combined, to 20.0% of a bank s capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. The Bank must also comply with other provisions designed to avoid an investment in low-quality assets.

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The Company and the Bank are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibit an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal shareholders and their related interests. These extensions of credit must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and must not involve more than the normal risk of repayment or present other unfavorable features.

Effect of Governmental Monetary Policies

The earnings of the Bank are affected by domestic and foreign conditions, particularly by the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve has had, and will continue to have, an important impact on the operating results of commercial banks through its power to implement monetary policy in order, among other things, to mitigate recessionary and inflationary pressures by regulating the national money supply. The techniques used by the Federal Reserve include setting the reserve requirements of member banks and establishing the discount rate on member bank borrowings. The Federal Reserve also conducts open market transactions in United States government securities.

Monitoring and Reporting Suspicious Activity

Under the Bank Secrecy Act, Internal Revenue Service (IRS) rules and other regulations, we are required to monitor and report unusual or suspicious account activity as well as transactions involving the transfer or withdrawal of amounts in excess of prescribed limits. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and know your customer standards in their dealings with financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures and controls generally require financial institutions to take reasonable steps:

- to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;
- to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;
- to ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and
- to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions are also required to establish anti-money laundering programs. The USA PATRIOT Act sets forth minimum standards for these programs, including:

- the development of internal policies, procedures, and controls;
- the designation of a compliance officer;
- an ongoing employee training program; and

an independent audit function to test the programs.

In addition, under the USA PATRIOT Act, the Secretary of the Treasury has adopted rules addressing a number of related issues, including increasing the cooperation and information sharing between financial institutions, regulators, and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Any financial institution complying with these rules will not be deemed to violate the privacy provisions of the GLB Act that are discussed above. Finally, under the regulations of the Office of Foreign Asset Control (OFAC), we are required to monitor and block transactions with certain specially designated nationals who OFAC has determined pose a risk to U.S. national security.

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Consumer Laws and Regulations

We are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the following list is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair and Accurate Credit Transactions Act, the Real Estate Settlement Procedures Act and the Fair Housing Act, among others. These laws and regulations, among other things, prohibit discrimination on the basis of race, gender or other designated characteristics and mandate various disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. These and other laws also limit finance charges or other fees or charges earned in our activities. We must comply with the applicable provisions of these consumer protection laws and regulations as part of our ongoing customer relations.

Technology Risk Management and Consumer Privacy

State and federal banking regulators have issued various policy statements emphasizing the importance of technology risk management and supervision in evaluating the safety and soundness of depository institutions with respect to banks that contract with outside vendors to provide data processing and core banking functions. The use of technology-related products, services, delivery channels and processes exposes a bank to various risks, particularly operational, privacy, security, strategic, reputational and compliance. Banks are generally expected to prudently manage technology-related risks as part of their comprehensive risk management policies by identifying, measuring, monitoring and controlling risks associated with the use of technology.

Under Section 501 of the GLB Act, the federal banking agencies have established appropriate standards for financial institutions regarding the implementation of safeguards to ensure the security and confidentiality of customer records and information, protection against any anticipated threats or hazards to the security or integrity of such records and protection against unauthorized access to or use of such records or information in a way that could result in substantial harm or inconvenience to a customer. Among other matters, the rules require each bank to implement a comprehensive written information security program that includes administrative, technical and physical safeguards relating to customer information.

Under the GLB Act, a financial institution must also provide its customers with a notice of privacy policies and practices. Section 502 prohibits a financial institution from disclosing nonpublic personal information about a customer to nonaffiliated third parties unless the institution satisfies various notice and opt-out requirements and the customer has not elected to opt out of the disclosure. Under Section 504, the agencies are authorized to issue regulations as necessary to implement notice requirements and restrictions on a financial institution s ability to disclose nonpublic personal information about customers to nonaffiliated third parties. Under the final rule the regulators adopted, all banks must develop initial and annual privacy notices which describe in general terms the bank s information sharing practices. Banks that share nonpublic personal information about customers with nonaffiliated third parties must also provide customers with an opt-out notice and a reasonable period of time for the customer to opt out of any such disclosure (with certain exceptions). Limitations are placed on the extent to which a bank can disclose an account number or access code for credit card, deposit or transaction accounts to any nonaffiliated third party for use in marketing.

Regulatory Reform and Legislation

The U.S. and global economies have experienced and are experiencing significant stress and disruptions in the financial sector. Dramatic slowdowns in the housing industry with falling home prices, elevated levels of foreclosures and high unemployment have created strains on financial institutions, including government-sponsored entities and investment banks. As a result, many financial institutions sought and continue to seek additional capital, merged or continue to seek mergers with other institutions and, in some cases, failed.

In response to the financial crisis affecting the banking and financial markets, in October 2008, the Emergency Economic Stabilization Act of 2008 (the EESA) was signed into law. Pursuant to the EESA, the U.S. Treasury (the Treasury) was authorized to purchase equity stakes in U.S. financial institutions. Under this program, known as the Troubled Asset Relief Program Capital Purchase Program (the TARP Capital Purchase Program), the Treasury made $250 billion of capital available to U.S. financial institutions through the purchase of preferred stock or subordinated debentures by the Treasury. In conjunction with the purchase of preferred stock from publicly-held financial institutions, the Treasury received warrants to purchase common stock with an aggregate market price equal to 15% of the total amount of the preferred investment. Participating financial institutions were required to adopt the Treasury s standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program and were restricted from increasing dividends to common shareholders or repurchasing common stock for three years without the consent of the Treasury. The Company did not participate in the TARP Capital Purchase Program.

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New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations, and competitive relationships of the nation s financial institutions. Included among current proposals are discussions around restructuring the regulatory framework in which we and the Bank operate. Further, under the EESA, Congress has the ability to impose after-the-fact terms and conditions on participants in the TARP Capital Purchase Program. On February 10, 2009, the Treasury announced the Financial Stability Plan under the EESA (the Financial Stability Plan) which was intended to further stabilize financial institutions and stimulate lending across a broad range of economic sectors. On February 18, 2009, President Obama signed the America Recovery and Reinvestment Act (ARRA), a broad economic stimulus package that included additional restrictions on, and potential additional regulation of, financial institutions. Additional regulations adopted as part of the EESA, the Financial Stability Plan, the ARRA, or other legislation may subject us to additional regulatory requirements. We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute.

ITEM 1A. RISK FACTORS

Our business is subject to certain risks, including those described below. The risks below do not describe all risks applicable to our business and are intended only as a summary of certain material factors that affect our operations in our industry and markets. New risks may emerge at any time, and we cannot predict such risks or estimate the extent to which they may affect our financial performance. More detailed information concerning these and other risks is contained in other sections of this Report, including *Management s Discussion and Analysis of Financial Condition and Results of Operations* .

Our business faces unpredictable economic conditions, which have had and could continue to have an adverse effect on us.

General economic conditions impact the banking industry. The credit quality of our loan portfolio necessarily reflects, among other things, the general economic conditions in the areas in which we conduct our business. Our continued financial success depends somewhat on factors beyond our control, including:

- general economic conditions, including national and local real estate markets;
- the supply of and demand for deposits and other investable funds;
- demand for loans and access to credit;
- interest rates; and
- federal, state and local laws affecting these matters.

Any substantial deterioration in any of the foregoing conditions could have a material adverse effect on our financial condition, results of operations and liquidity, and would also likely adversely affect the market price of our common stock.

In our business, we must effectively manage our credit risk.

As a lender, we are exposed to the risk that our loan customers may not repay their loans according to the terms of these loans and the collateral securing the payment of these loans may be insufficient to fully compensate us for the outstanding balance of the loan plus the costs to dispose of the collateral. We may experience significant loan losses, which could have a material adverse effect on our operating results and financial condition. Management makes various assumptions and judgments about the collectability of our loan portfolio, including the diversification by industry of our commercial loan portfolio, the amount of nonperforming loans and related collateral, the volume, growth and composition of our loan portfolio, the effects on the loan portfolio of current economic indicators and their probable impact on borrowers and the evaluation of our loan portfolio through our internal loan review process and other relevant factors.

We maintain an allowance for loan losses, which is an allowance established through a provision for loan losses charged to expense that represents management s best estimate of probable losses inherent in our loan portfolio. Additional credit losses will likely occur in the future and may occur at a rate greater than we have experienced to date. In determining the amount of the allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions. If our assumptions prove to be incorrect, our current allowance may not be sufficient and adjustments may be necessary to allow for different economic conditions or adverse developments in our loan portfolio. Material additions to the allowance could materially decrease our net income.

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In addition, federal and state regulators periodically review the adequacy of our allowance for loan losses and may require us to increase our provision for loan losses or recognize further charge-offs, based on judgments different than those of our management. Any increase in our allowance for loan losses or charge-offs as required by these regulatory agencies could have a material negative effect on our operating results, financial condition and liquidity.

Our business is concentrated in southeast Georgia and northeast Florida and a downturn in the local economy may adversely affect our business.

The business of the Bank is concentrated in southeast Georgia and northeast Florida. Most of our customers and revenue are derived from this area. The economy of this region is focused on real estate development, tourism and recreation, shipping and transportation, military, agriculture (including timber), governmental, commercial and industrial, medical, and education. Because we generally do not derive revenue or customers from other parts of the region or nation, our business and operations are dependent on economic conditions in our markets. Any significant decline in one or more segments of the local economy could adversely affect our business, revenue, operations and properties.

If the communities in which we operate do not recover and grow as anticipated or if prevailing economic conditions locally or nationally do not improve, our business may continue to be negatively impacted. The current economic downturn, increase in unemployment, and other events that have negatively affected household and corporate incomes both nationally and locally have decreased the demand for loans and our other products and services and have increased the number of customers who fail to pay interest or principal on their loans. Furthermore, if the economy improves in the future, we may not benefit from any market growth or favorable economic conditions in our market areas if they do occur.

Changes in economic conditions could cause an increase in delinquencies and non-performing assets, including loan charge-offs, which could depress our net income and growth.

If we continue to see negative economic conditions in the United States as a whole or in the portions of Georgia and Florida that we serve, we could continue to experience a high rate of delinquencies and loan charge-offs, which would continue to reduce our net income and adversely affect our financial condition.

The value of real estate collateral may fluctuate significantly resulting in an under-collateralized loan portfolio.

The market value of real estate can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. We are in the fourth year of a local real estate market depression where we have seen dramatic declines in real estate valuations. At December 31, 2011, approximately 85.6% of our loan portfolio includes real estate secured loans. If the value of the real estate serving as collateral for our loan portfolio were to continue to decline materially, a significant part of our loan portfolio could become under-collateralized. As we have experienced in recent years, if the loans that are collateralized by real estate become troubled during a time when market conditions are declining or have declined, then, in the event of foreclosure, we may not be able to realize the amount of collateral that we anticipated at the time of originating the loan. These factors have had a material adverse effect on our provision for loan losses and our operating results and financial condition.

Furthermore, to the extent that real estate collateral is obtained through foreclosure, the costs of holding and marketing the real estate collateral, as well as the ultimate values obtained from disposition, could continue to reduce our earnings and adversely affect our financial condition.

We will realize future losses if the proceeds we receive upon liquidation of nonperforming assets, particularly foreclosed real estate, are less than their carrying values.

Foreclosed real estate is carried on our books at fair value (typically based on appraisals) less estimated selling costs. Deteriorating market conditions could result in additional losses. Over the last two years, we have written-down foreclosed real estate by $4,274,026. Unless real estate markets stabilize and nonperforming levels moderate, the Company expects additional write-downs to be necessary in 2012.

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Difficult market conditions and economic trends have adversely affected our industry and our business and may continue to do so.

As a result of the negative developments in the financial industry, new federal and state laws and regulations regarding lending, funding practices, liquidity standards, and other financial practices have been enacted; the Dodd-Frank Act, which is further discussed in this Report under the section *Supervision and Regulation* , is a case in point. Additionally, bank regulatory agencies have been, and are expected to continue being, aggressive in responding to concerns and trends identified in examinations. Difficult market conditions and the impact of new legislation in response to these developments could restrict our business operations, including our ability to originate loans, and increase our cost of compliance, divert our resources, and adversely affect our profitability.

Since August 2008, 132 banks and thrifts failed in Georgia and Florida, including numerous institutions with a presence in our markets. The closure of these institutions and the subsequent liquidation of their assets in our markets at depressed values by the FDIC and the acquiring institutions have had a negative impact on our business and on our customers in real estate-related businesses. It could take several years for the market to absorb the real estate inventories held by the FDIC and other financial institutions in our markets.

We are subject to extensive legislation and regulation that could limit or restrict our activities and adversely affect our earnings and financial condition.

We operate in a highly regulated industry and are subject to examination, supervision and comprehensive regulation by various federal and state agencies. Many of these regulations are further discussed in this Report under the section *Supervision and Regulation* . Our compliance with these regulations is costly and restricts certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged, interest rates paid on deposits, and locations of offices. Our failure to comply with these requirements can lead to, among other remedies, administrative enforcement actions, termination or suspension of our licenses, rights of rescission for borrowers, and class action lawsuits. Many of these regulations are intended to protect depositors, the public and the FDIC rather than shareholders. The laws and regulations applicable to the banking industry are changing rapidly to reflect the government s concerns about the economy and the banking system, and these changes may adversely affect our business and profitability. Changes to statutes, regulations or regulatory policies, and the interpretation and implementation of new statutes, regulations or policies could affect us in substantial and unpredictable ways, including limiting the types of financial services and products we may offer and/or increasing the ability of nonbanks to offer competing financial services and products.

Further, the legislation and regulations recently enacted in an effort to either stabilize or reform the financial and capital markets may have unintended harmful consequences on the U.S. financial system and our business. The overall effects of these and other legislative and regulatory efforts on the financial markets remain uncertain and they may not have the intended results. Should these or other legislative or regulatory initiatives have unintended effects, our business, financial condition, results of operations and prospects could be materially and adversely affected.

In addition, we may need to modify our strategies and business operations in response to these changes. We may also incur increased capital requirements and constraints or additional costs to satisfy new regulatory requirements. Given the volatile nature of the current regulatory environment and the uncertainties underlying efforts to mitigate or reverse disruptions, we may not timely anticipate or manage existing, new or additional risks, contingencies or developments in the current or future environment. Our failure to do so could materially and adversely affect our business, financial condition, results of operations and prospects.

We may need to raise additional capital in the future, but that capital may not be available when we need it or may be dilutive.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. At some point, particularly if our asset quality or earnings were to continue to deteriorate significantly, we may need to raise additional capital to support our operations and any future growth, to protect against any further deterioration in our loan portfolio, or to meet our other commitments and business needs.

Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of our control, and on our financial performance. Volatility and disruption in the capital and credit markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers underlying financial strength. Such market conditions may disrupt our ability to raise additional capital when needed.

If we cannot raise additional capital when needed, our results of operations and financial condition may be adversely affected, and our banking regulators may subject the Bank to a formal regulatory enforcement action. In addition, the issuance of additional shares of our common stock will dilute the ownership interest of our common shareholders.

Diminished access to alternative sources of liquidity could adversely affect our net income, net interest margin and overall liquidity.

Although we have seldom used them, we have historically had access to a number of alternative sources of liquidity such as advances from the Federal Home Loan Bank of Atlanta (the FHLB), secured and unsecured lines of credit from other banks and the Federal Reserve s discount window. Given the recent volatility in the credit and liquidity markets and a deterioration in our financial condition resulting from an increase in nonperforming assets and a decrease in earnings, we may not be able to obtain liquidity on terms that are favorable to us, or at all. In addition, financial institutions are unwilling to extend credit to banks because of concerns about the banking industry and the economy generally and, as discussed above, there may not be a viable market for raising equity capital. If our access to these sources of liquidity is diminished, or if it is only available on unfavorable terms, then our net income, net interest margin and overall liquidity could be adversely affected.

Our net interest income could be negatively affected by the continued low level of short-term interest rates, a sudden rising interest rate environment, recent developments in the credit and real estate markets and competition in our primary market area.

As a community bank, our earnings significantly depend on our net interest income, which is the difference between the income that we earn on interest-earning assets, such as loans and investment securities, and the expense that we pay on interest-bearing liabilities, such as deposits and borrowings. Therefore, any change in general market interest rates, including changes resulting from changes in the Federal Reserve s fiscal and monetary policies, affects us more than non-financial institutions and can have a significant effect on our net interest income and net income.

Through monetary policy, the Federal Reserve has held short-term interest rates at historic lows since 2008. A significant portion of our loans, including residential construction and development loans and other commercial loans, bears interest at variable rates. The interest rates on a significant part of these loans decreased when the Federal Reserve reduced interest rates. In response, we instituted interest rate floors on most of our variable rate loans that are now considered above market rates. In addition, many of our customers have taken advantage of the low interest rate environment to borrow at fixed rates for terms up to five years. Accordingly, an increase in interest rates may not result in an increase in our interest income. Also, as interest rates rise, our interest expense for deposits and other borrowings will likely also rise. In addition, an increase in interest rates may decrease the demand for consumer and commercial credit, including real estate loans, which are a major component of our loan portfolio. Furthermore, increases in interest rates will add to the borrowing costs of our loan customers, which may adversely affect their ability to repay their loans.

Changes in the level of interest rates also may negatively affect our ability to originate real estate loans, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately affect our earnings. A decline in the market value of our assets has limited our ability to borrow additional funds and could result in our lenders requiring additional collateral from us under our borrowing agreements. As a result, we could be required to sell some of our loans and investments under adverse market conditions, upon terms that are not favorable to us, to maintain our liquidity. If those sales are made at prices lower than the recorded amounts of the investments and loans, we will incur losses.

A decline in loans outstanding, increases in nonperforming loans and the continued low interest rate environment reduced our net interest income during the three years ended December 31, 2011 and could cause additional pressure on net interest income in future periods. This reduction in net interest income may also be exacerbated by the high level of competition that we face in our markets. Any significant reduction in our net interest income could negatively affect our business and could have a material adverse impact on our capital, financial condition and results of operations.

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We face strong competition from other financial services providers.

We operate in highly competitive markets for the products and services we offer. The competition among financial services providers to attract and retain customers is strong. Customer loyalty can be easily influenced by a competitor s new products, especially offerings that could provide cost savings or a higher return to the customer. Some of our competitors may be better able to provide a wider range of products and services over a greater geographic area. We compete with commercial banks, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds, and other mutual funds, as well as other super-regional, national and international financial institutions that operate in our market areas and elsewhere. Moreover, this competitive industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Many of our competitors have greater financial resources, fewer regulatory constraints and some have lower cost structures. While we believe we can and do successfully compete with these other financial institutions in our market areas, we may face a competitive disadvantage as a result of our smaller size, lack of geographic diversification and inability to spread our marketing costs across a broader market. As a result of these various sources of competition, we could lose business to competitors or be forced to price products and services on less advantageous terms to keep or attract customers, either of which could adversely affect our profitability.

Additionally, customers could pursue alternatives to bank deposits and bank transactions, causing us to lose a relatively inexpensive source of funding and fee income. For example, customers may perceive other investments, such as the stock market, as providing superior returns. And, technology now allows consumers to completely bypass banks in paying bills, transferring funds, and completing other financial transactions. This process could result in loss of deposits and related fee income. Conversely, when customers move borrowing relationships to other parties, we lose interest income.

If problem asset levels and real estate concentrations are not reduced, we could face formal regulatory action and loss of liquidity sources.

If our problem asset levels and real estate concentrations are not reduced, we could face a formal regulatory order and loss of liquidity sources, including the Federal Reserve discount window. Our future lending activities and growth prospects could be significantly curtailed, we could be required to take significant write-downs on problem assets, and our deposit insurance assessments could increase substantially. Publication of an enforcement order could harm our reputation and result in loss of deposits and market share. Besides our financial condition and operating results, our stock price could be materially and adversely affected.

Our financial instruments carried at fair value expose us to certain market risks.

We maintain an investment portfolio of securities available-for-sale, which includes various types of debt instruments and maturities. Instruments carried at fair value are exposed to market risks related to changes in interest rates, market liquidity, and default risks. Changes in the market values of these instruments could have a material adverse impact on our financial condition. Additionally, accounting regulations may require us to record other-than-temporary impairment losses. We may classify additional financial assets or liabilities at fair value in the future.

Diminished access to historical and alternative sources of liquidity could adversely affect our operating results, net interest margin, and our overall liquidity.

Deposits are our primary source of liquidity. In the current environment, customer confidence is a critical element in growing and retaining deposits, and heightened sensitivity to our asset quality could affect the stability of our deposit base. If our asset quality continues to deteriorate, our ability to grow and retain deposits could be curtailed, increasing our costs of funds and negatively impacting our overall liquidity and financial condition. We have historically had access to alternative sources of liquidity, including unsecured lines of credit from correspondent banks. Due to nonperforming assets and other trends, certain of these sources, including correspondent lines, are currently not available. The reduction in these alternative sources of liquidity has increased our reliance on deposits.

Recapture of our deferred tax asset balance (i.e. reversal of the valuation allowance) is subject to considerable judgment.

At December 31, 2011, we recorded a $7,464,854 valuation allowance for deferred tax assets. The establishment of the valuation allowance has significantly and adversely affected the Company s operating results and financial conditions, including regulatory capital ratios. We expect to reverse the majority of the valuation allowance for deferred tax assets once we return to a sustained level of profitability. Like other estimates, the reversal of the valuation allowance is subject to considerable judgment, and we cannot affirm with certainty when the deferred tax asset balance will be restored.

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Issuance or sale of common stock or other equity securities resulting in an ownership change, as defined in the Internal Revenue Code, could impair our ability to fully utilize certain tax benefits.

Our ability to use realized net operating losses to offset future taxable income may be significantly limited if we experience an ownership change as defined by Section 382 of the Internal Revenue Code of 1986, as amended. An ownership change under Section 382 generally occurs when the aggregate percentage of stock held by 5% shareholders increases by more than 50% over a rolling three year period. In general, the rules of Section 382 allow post-change corporations to use pre-change net operating losses, but impose an annual limitation equal to the value of the corporation s stock immediately before the ownership change multiplied by the long-term tax-exempt rate, as defined by the Internal