



BNCCORP

Quarterly Report

For the quarter ended March 31, 2013

BNCCORP, INC.

(OTC Markets:BNCC)

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BNCCORP, INC.
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March 31, 2013

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FINANCIAL INFORMATION

Item 1. Financial Statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets
(In thousands, except share data)

ASSETS	March 31, 2013 (unaudited)	December 31, 2012
CASH AND CASH EQUIVALENTS	\$ 89,534	\$ 40,790
INVESTMENT SECURITIES AVAILABLE FOR SALE	319,488	300,549
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	2,602	2,601
LOANS HELD FOR SALE-MORTGAGE BANKING	66,037	95,095
LOANS AND LEASES HELD FOR INVESTMENT	282,949	289,469
ALLOWANCE FOR CREDIT LOSSES	(9,873)	(10,091)
Net loans and leases held for investment	273,076	279,378
OTHER REAL ESTATE, net	3,336	5,131
PREMISES AND EQUIPMENT, net	16,160	15,932
ACCRUED INTEREST RECEIVABLE	2,545	2,590
OTHER	26,622	28,710
Total assets	<u>\$ 799,400</u>	<u>\$ 770,776</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	\$ 106,238	\$ 131,593
Interest-bearing –		
Savings, interest checking and money market	372,679	313,051
Time deposits under \$100,000	126,070	128,150
Time deposits \$100,000 and over	76,725	76,810
Total deposits	681,712	649,604
SHORT-TERM BORROWINGS	16,098	11,700
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	22,430	22,430
ACCRUED INTEREST PAYABLE	478	5,045
ACCRUED EXPENSES	5,625	10,144
OTHER	1,797	3,123
Total liabilities	728,140	702,046
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.01 par value – Authorized 2,000,000 shares:		
Preferred stock - 5% Series A 20,093 shares outstanding;	19,915	19,859
Preferred stock - 9% Series B 1,005 shares outstanding;	1,023	1,029
Common stock, \$.01 par value – Authorized 35,000,000 shares; 3,300,652 and 3,300,652 shares issued and outstanding	33	33
Capital surplus – common stock	27,258	27,257
Retained earnings	24,115	20,655
Treasury stock (368,001 and 368,001 shares, respectively)	(5,064)	(5,064)
Accumulated other comprehensive income, net	3,980	4,961
Total stockholders' equity	<u>71,260</u>	<u>68,730</u>
Total liabilities and stockholders' equity	<u>\$ 799,400</u>	<u>\$ 770,776</u>

See accompanying notes to consolidated financial statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Income
For the Three Months Ended March 31,
(In thousands, except per share data, unaudited)

	<u>2013</u>	<u>2012</u>
INTEREST INCOME:		
Interest and fees on loans	\$ 4,000	\$ 4,200
Interest and dividends on investments		
Taxable	1,339	1,696
Tax-exempt	282	206
Dividends	28	29
Total interest income	<u>5,649</u>	<u>6,131</u>
INTEREST EXPENSE:		
Deposits	716	1,095
Short-term borrowings	10	18
Subordinated debentures	290	373
Total interest expense	<u>1,016</u>	<u>1,486</u>
Net interest income	4,633	4,645
PROVISION FOR CREDIT LOSSES	700	100
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	<u>3,933</u>	<u>4,545</u>
NON-INTEREST INCOME:		
Bank charges and service fees	617	563
Wealth management revenues	327	351
Mortgage banking revenues	8,247	4,247
Gains on sales of loans, net	755	338
Gains on sales of investment securities, net	1,210	-
Other	168	198
Total non-interest income	<u>11,324</u>	<u>5,697</u>
NON-INTEREST EXPENSE:		
Salaries and employee benefits	5,035	3,713
Professional services	969	973
Data processing fees	720	669
Marketing and promotion	509	406
Occupancy	518	495
Regulatory costs	324	293
Depreciation and amortization	305	278
Office supplies and postage	155	180
Other real estate costs	77	828
Other	785	837
Total non-interest expense	<u>9,397</u>	<u>8,672</u>
Income before income taxes	5,860	1,570
Income tax expense	2,075	2
Net income	3,785	1,568
Preferred stock costs	(324)	(358)
Net income available to common shareholders	<u>\$ 3,461</u>	<u>\$ 1,210</u>
Basic earnings per common share	<u>\$ 1.05</u>	<u>\$ 0.37</u>
Diluted earnings per common share	<u>\$ 1.00</u>	<u>\$ 0.37</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
For the Three Months Ended March 31,
(In thousands, unaudited)

	2013	2012	
NET INCOME	\$ 3,785		\$ 1,568
Unrealized gain (loss) on securities available for sale	\$ (373)	\$ 522	
Reclassification adjustment for (gain) loss included in net income	<u>(1,210)</u>	<u>-</u>	
Other comprehensive income (loss) before tax	(1,583)	522	
Income tax benefit (expense) related to items of other comprehensive income	<u>602</u>	<u>-</u>	
Other comprehensive income (loss)	<u>(981)</u>	<u>522</u>	<u>522</u>
TOTAL COMPREHENSIVE INCOME	<u>\$ 2,804</u>		<u>\$ 2,090</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the Three Months Ended March 31,
(In thousands, except share data, unaudited)

	Preferred Stock		Common Stock		Capital	Retained	Treasury	Accumulated	Total
	Shares	Amount	Shares	Amount	Surplus	Earnings	Stock	Other	
					Common	(Deficit)		Comprehensive	
BALANCE, December 31, 2011	21,098	\$ 20,687	3,301,007	\$ 33	\$ 27,217	\$ (4,508)	\$ (5,076)	\$ 3,514	\$ 41,867
Net income	-	-	-	-	-	1,568	-	-	1,568
Other comprehensive income (loss)	-	-	-	-	-	-	-	522	522
Preferred stock amortization, net	-	50	-	-	-	(50)	-	-	-
Dividend on preferred stock	-	-	-	-	-	(307)	-	-	(307)
Impact of share-based compensation	-	-	-	-	37	-	-	-	37
BALANCE, March 31, 2012	21,098	\$ 20,737	3,301,007	\$ 33	\$ 27,254	\$ (3,297)	\$ (5,076)	\$ 4,036	\$ 43,687
BALANCE, December 31, 2012	21,098	\$ 20,888	3,300,652	\$ 33	\$ 27,257	\$ 20,655	\$ (5,064)	\$ 4,961	\$ 68,730
Net income	-	-	-	-	-	3,785	-	-	3,785
Other comprehensive income (loss)	-	-	-	-	-	-	-	(981)	(981)
Preferred stock amortization, net	-	50	-	-	-	(50)	-	-	-
Dividend on preferred stock	-	-	-	-	-	(275)	-	-	(275)
Impact of share-based compensation	-	-	-	-	1	-	-	-	1
BALANCE, March 31, 2013	21,098	\$ 20,938	3,300,652	\$ 33	\$ 27,258	\$ 24,115	\$ (5,064)	\$ 3,980	\$ 71,260

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIESConsolidated Statements of Cash Flows
For the Three Months Ended March 31,
(In thousands, unaudited)

	<u>2013</u>	<u>2012</u>
OPERATING ACTIVITIES:		
Net income	\$ 3,785	\$ 1,568
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision for credit losses	700	100
Provision for other real estate losses	-	700
Depreciation and amortization	305	278
Net amortization of premiums and (discounts)	1,826	975
Share-based compensation	1	37
Change in interest receivable and other assets, net	930	209
(Gain) loss on sale of bank premises and equipment	6	5
Net realized gain on sales of investment securities	(1,210)	-
Provision for deferred income taxes	238	-
Change in other liabilities, net	(10,085)	(1,650)
Funding of originations of loans held for sale	(290,027)	(240,846)
Proceeds from sales of loans held for sale	318,114	247,010
Fair value adjustment for loans held for sale	971	552
Unrealized gain on mortgage banking financial instruments	363	-
Proceeds from sales of loans	7,445	4,939
Gains on sales of loans, net	(743)	(338)
Net cash provided by (used in) operating activities	<u>32,619</u>	<u>13,539</u>
INVESTING ACTIVITIES:		
Purchases of investment securities	(72,574)	(19,543)
Proceeds from sales of investment securities	39,147	-
Proceeds from maturities of investment securities	12,891	7,133
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(1)	-
Sales of Federal Reserve and Federal Home Loan Bank Stock	-	50
Net (increase) decrease in loans held for investment	(1,100)	13,773
Proceeds from sales of other real estate	1,795	-
Additions to bank premises and equipment	(539)	(287)
Net cash provided by (used in) investing activities	<u>(20,381)</u>	<u>1,126</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows, continued
For the Three Months Ended March 31,
(In thousands, unaudited)

	2013	2012
FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	\$ 32,108	\$ 23,507
Net increase (decrease) in short-term borrowings	4,398	1,960
Repayments of Federal Home Loan Bank advances	-	-
Proceeds from Federal Home Loan Bank advances	-	-
Net cash provided by (used in) financing activities	36,506	25,467
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	48,744	40,132
CASH AND CASH EQUIVALENTS, beginning of period	40,790	19,296
CASH AND CASH EQUIVALENTS, end of period	\$ 89,534	\$ 59,428
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 6,059	\$ 1,193
Income taxes paid (received)	\$ (1)	\$ 7
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to other real estate in settlement of loans	\$ -	\$ -

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
March 31, 2013

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). BNCCORP operates community banking and wealth management businesses in Arizona, Minnesota and North Dakota from 14 locations. The Bank also conducts mortgage banking from 12 locations in Arizona, Minnesota, North Dakota, Illinois, 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, 2012. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2012 audited consolidated financial statements have been omitted from these interim consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2012 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 March 31, 2013 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, 2012.

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS

FASB ASU 2011-02, *Receivables (Topic 310), A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, clarifies when the restructuring of a receivable should be considered a troubled debt restructuring (TDR). FASB issued the guidance in response to constituents' concerns that creditors were inconsistently applying the guidance for indentifying TDRs. The ASU provides additional guidance for determining whether the creditor has granted a concession and whether the debtor is experiencing financial difficulty. For nonpublic companies, this ASU is effective for annual periods ending after December 15, 2012, including interim periods within those annual periods. Information related to this ASU and the related disclosures are included in Note 5 in the Company's notes to the consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments

in this ASU changes the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements in order to improve consistency in wording between U.S. GAAP and IFRS. For BNCCORP, this ASU is effective for annual periods beginning after December 15, 2011. The adoption of this ASU in 2012 did not have a material impact on the Company's consolidated financial statements other than to change the disclosures relating to fair value measurements.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income (Topic 220)*, which requires companies to report total net income, each component of comprehensive income, and total comprehensive income on the face of the income statement, or as two consecutive statements. The components of comprehensive income are not changed, nor does the ASU affect how earnings per share is calculated or reported. The adoption of this ASU in 2013 did not have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued Accounting Standards Update 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. This update requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, entities are required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. This ASU is effective for fiscal years and interim periods beginning after December 15, 2013 for non-public companies. The adoption of this ASU in 2014 is not anticipated to have a material impact on the Company's consolidated financial statements.

In December 2012, the FASB issued for public comment a draft proposal designed to improve financial reporting about expected credit losses on loans and other financial assets held by banks, financial institutions and other organizations. The proposed ASU, *Financial Instruments - Credit Losses*, proposes a new accounting model which would change the definition from inherent credit losses to expected credit losses, which could result in more timely recognition of credit losses, and also would provide additional transparency about credit risk. Stakeholders have been asked to review and provide comments to the FASB on the proposal by May 31, 2013.

NOTE 3 – Capital and Current Operating Environment

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

	Actual		For Capital Adequacy Purposes		To be Well Capitalized		Amount in Excess of Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2013								
Total Risk Based Capital:								
Consolidated	\$ 94,600	24.50 %	\$ 30,891	≥8.0 %	\$ N/A	N/A %	\$ N/A	N/A %
BNC National Bank	87,907	23.15	30,375	≥8.0	37,969	10.0	49,938	13.15
Tier 1 Risk Based Capital :								
Consolidated	88,190	22.84	15,446	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	83,097	21.89	15,188	≥4.0	22,781	6.0	60,316	15.89
Tier 1 Leverage Capital:								
Consolidated	88,190	11.26	31,319	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	83,097	10.64	31,242	≥4.0	39,053	5.0	44,044	5.64
Tangible Equity (to total assets):								
Consolidated tangible equity	71,225	8.91	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	87,496	10.97	N/A	N/A	N/A	N/A	N/A	N/A
Tangible Common Equity (to total assets):								
Consolidated tangible common equity	50,286	6.29	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	87,496	10.97	N/A	N/A	N/A	N/A	N/A	N/A
December 31, 2012								
Total Risk Based Capital:								
Consolidated	\$ 90,766	22.43 %	\$ 32,371	≥8.0 %	\$ N/A	N/A %	\$ N/A	N/A %
BNC National Bank	84,003	21.06	31,905	≥8.0	39,881	10.0	44,122	11.06
Tier 1 Risk Based Capital :								
Consolidated	82,908	20.49	16,185	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	78,954	19.80	15,953	≥4.0	23,929	6.0	55,025	13.80
Tier 1 Leverage Capital:								
Consolidated	82,908	11.17	29,679	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	78,954	10.68	29,579	≥4.0	36,973	5.0	41,981	5.68
Tangible Equity (to total assets):								
Consolidated tangible equity	68,690	8.92	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	84,330	10.97	N/A	N/A	N/A	N/A	N/A	N/A
Tangible Common Equity (to total assets):								
Consolidated tangible common equity	47,801	6.21	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	84,330	10.97	N/A	N/A	N/A	N/A	N/A	N/A

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

Although Tangible Common Equity (TCE) is not a regulatory capital measure, TCE is a ratio that is commonly used to assess the capital strength of banking entities. Accordingly, we have included the ratio in the preceding table.

The most recent notifications from the Office of the Comptroller of the Currency (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.

NOTE 4 – Loans and Leases

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

	<u>March 31, 2013</u>	<u>December 31, 2012</u>
Loans held for sale-mortgage banking	\$ 66,037	\$ 95,095
Commercial and industrial	\$ 122,567	\$ 116,891
Commercial real estate	72,316	87,258
SBA	16,394	15,823
Consumer	27,063	26,614
Land and land development	29,370	31,065
Construction	15,202	11,814
	<u>282,912</u>	<u>289,465</u>
Unearned income and net unamortized deferred fees and costs	<u>37</u>	<u>4</u>
Loans, net of unearned income and unamortized fees and costs	282,949	289,469
Allowance for credit losses	<u>(9,873)</u>	<u>(10,091)</u>
Net loans and leases held for investment	<u>\$ 273,076</u>	<u>\$ 279,378</u>

NOTE 5 – Allowance for Credit Losses

Transactions in the allowance for credit losses were as follows (in thousands):

Three Months Ended March 31, 2013

	<u>Commercial and industrial</u>	<u>Commercial real estate</u>	<u>SBA</u>	<u>Consumer</u>	<u>Land and land development</u>	<u>Construction</u>	<u>Total</u>
Balance, beginning of period	\$ 2,546	\$ 4,790	\$ 616	\$ 382	\$ 1,609	\$ 148	\$ 10,091
Provision	442	(288)	96	85	305	60	700
Loans charged off	(916)	(3)	-	(25)	-	-	(944)
Loan recoveries	-	8	-	6	12	-	26
Balance, end of period	<u>\$ 2,072</u>	<u>\$ 4,507</u>	<u>\$ 712</u>	<u>\$ 448</u>	<u>\$ 1,926</u>	<u>\$ 208</u>	<u>\$ 9,873</u>

Three Months Ended March 31, 2012

	<u>Commercial and industrial</u>	<u>Commercial real estate</u>	<u>SBA</u>	<u>Consumer</u>	<u>Land and land development</u>	<u>Construction</u>	<u>Total</u>
Balance, beginning of period	\$ 1,639	\$ 5,518	\$ 436	\$ 448	\$ 2,532	\$ 57	\$ 10,630
Provision	135	(138)	97	(99)	81	24	100
Loans charged off	-	(300)	-	(3)	-	-	(303)
Loan recoveries	-	15	1	1	103	-	120
Balance, end of period	<u>\$ 1,774</u>	<u>\$ 5,095</u>	<u>\$ 534</u>	<u>\$ 347</u>	<u>\$ 2,716</u>	<u>\$ 81</u>	<u>\$ 10,547</u>

Performing and non-accrual loans

The Bank's key credit quality indicator is the loan's performance status, defined as accrual or non-accrual. Performing loans are considered to have a lower risk of loss and are on accrual status. Non-accrual loans include loans on which the accrual of interest has been discontinued. Accrual of interest is discontinued when we believe that the borrower's financial condition is such that the collection of interest is doubtful. A delinquent loan is generally placed on non-accrual status when it becomes 90 days or more past due unless the loan is well secured and in the process of collection. When a loan is placed on non-accrual status, accrued but uncollected interest income applicable to the current reporting period is reversed against interest income. Accrued but uncollected interest income applicable to previous reporting periods is charged against the allowance for credit losses. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. Delinquent balances are determined based on the contractual terms of the loan adjusted for charge-offs and payments applied to principal.

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

	March 31, 2013					
	Current	31-89 Days Past Due	90 Days or More Past Due and Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	\$ 71,902	\$ 26	\$ 2	\$ 71,930	\$ 3,007	\$ 74,937
Agriculture	16,011	-	-	16,011	-	16,011
Owner-occupied commercial real estate	31,619	-	-	31,619	-	31,619
Commercial real estate	67,886	-	-	67,886	4,430	72,316
SBA	16,394	-	-	16,394	-	16,394
Consumer:						
Automobile	6,358	60	34	6,452	-	6,452
Home equity	3,390	-	-	3,390	-	3,390
1st mortgage	9,458	-	-	9,458	-	9,458
Other	7,755	3	5	7,763	-	7,763
Land and land development	26,578	-	-	26,578	2,792	29,370
Construction	15,202	-	-	15,202	-	15,202
Total loans held for investment	<u>272,553</u>	<u>89</u>	<u>41</u>	<u>272,683</u>	<u>10,229</u>	<u>282,912</u>
Loans held for sale	<u>66,035</u>	<u>2</u>	<u>-</u>	<u>66,037</u>	<u>-</u>	<u>66,037</u>
Total gross loans	<u>\$ 338,588</u>	<u>\$ 91</u>	<u>\$ 41</u>	<u>\$ 338,720</u>	<u>\$ 10,229</u>	<u>\$ 348,949</u>

December 31, 2012

	<u>Current</u>	<u>31-89 Days Past Due</u>	<u>90 Days or More Past Due and Accruing</u>	<u>Total Performing</u>	<u>Non-accrual</u>	<u>Total</u>
Commercial and industrial:						
Business loans	\$ 64,390	\$ 3	\$ -	\$ 64,393	\$ 3,211	\$ 67,604
Agriculture	16,319	-	-	16,319	-	16,319
Owner-occupied commercial real estate	32,968	-	-	32,968	-	32,968
Commercial real estate	82,761	-	-	82,761	4,497	87,258
SBA	15,823	-	-	15,823	-	15,823
Consumer:						
Automobile	5,762	58	-	5,820	-	5,820
Home equity	3,779	-	-	3,779	-	3,779
1st mortgage	9,462	-	-	9,462	-	9,462
Other	7,534	8	11	7,553	-	7,553
Land and land development	28,273	-	-	28,273	2,792	31,065
Construction	11,814	-	-	11,814	-	11,814
Total loans held for investment	<u>278,885</u>	<u>69</u>	<u>11</u>	<u>278,965</u>	<u>10,500</u>	<u>289,465</u>
Loans held for sale	<u>95,094</u>	<u>-</u>	<u>1</u>	<u>95,095</u>	<u>-</u>	<u>95,095</u>
Total gross loans	<u>\$ 373,979</u>	<u>\$ 69</u>	<u>\$ 12</u>	<u>\$ 374,060</u>	<u>\$ 10,500</u>	<u>\$ 384,560</u>

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

	<u>Three Months Ended March 31,</u>	
	<u>2013</u>	<u>2012</u>
Interest income that would have been recorded	\$ 124	\$ 62
Interest income recorded	-	-
Effect on interest income	<u>\$ 124</u>	<u>\$ 62</u>

Impaired loans

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

The following table summarizes impaired loans and related allowances (in thousands):

March 31, 2013

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Balance</u>	<u>Interest Income Recognized</u>
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 3,000	\$ 3,000	\$ 400	\$ 3,000	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	6,857	4,430	1,066	4,464	-
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	661	661	300	661	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	<u>\$ 10,518</u>	<u>\$ 8,091</u>	<u>\$ 1,766</u>	<u>\$ 8,125</u>	<u>\$ -</u>
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ -	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	2,130	2,130	-	2,130	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	<u>\$ 2,130</u>	<u>\$ 2,130</u>	<u>\$ -</u>	<u>\$ 2,130</u>	<u>\$ -</u>
TOTAL IMPAIRED LOANS	<u>\$ 12,648</u>	<u>\$ 10,221</u>	<u>\$ 1,766</u>	<u>\$ 10,255</u>	<u>\$ -</u>

December 31, 2012

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Balance</u>	<u>Interest Income Recognized</u>
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 3,220	\$ 3,201	\$ 601	\$ 3,204	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	6,857	4,497	1,200	4,640	-
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	661	661	300	661	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	<u>\$ 10,738</u>	<u>\$ 8,359</u>	<u>\$ 2,101</u>	<u>\$ 8,505</u>	<u>\$ -</u>
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ -	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	2,130	2,130	-	2,130	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	<u>\$ 2,130</u>	<u>\$ 2,130</u>	<u>\$ -</u>	<u>\$ 2,130</u>	<u>\$ -</u>
TOTAL IMPAIRED LOANS	<u><u>\$ 12,868</u></u>	<u><u>\$ 10,489</u></u>	<u><u>\$ 2,101</u></u>	<u><u>\$ 10,635</u></u>	<u><u>\$ -</u></u>

Troubled Debt Restructuring (TDRs)

Included in loans receivable, net, are certain loans that have been modified in order to maximize collection of loan balances. If the Company, for legal or economic reasons related to the borrower's financial difficulties, grants a concession compared to the original terms and conditions of the loan, the modified loan is considered a troubled debt restructuring.

During 2012, the Company adopted FASB ASU No. 2011-02, *Receivables (Topic 310), A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, which modified guidance for identifying restructurings of receivables that constitute a TDR.

The tables below summarize the amounts of restructured loans (in thousands):

	March 31, 2013			
	<u>Accrual</u>	<u>Non-accrual</u>	<u>Total</u>	<u>Reserve</u>
Commercial and industrial:				
Business loans	\$ 98	\$ -	\$ 98	\$ 15
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	3,843	4,430	8,273	1,162
SBA	-	-	-	-
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	796	-	796	20
Other	-	-	-	-
Land and land development	3,161	-	3,161	79
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 7,898</u>	<u>\$ 4,430</u>	<u>\$ 12,328</u>	<u>\$ 1,276</u>

	December 31, 2012			
	<u>Accrual</u>	<u>Non-accrual</u>	<u>Total</u>	<u>Reserve</u>
Commercial and industrial:				
Business loans	\$ 101	\$ -	\$ 101	\$ 2
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	3,810	4,497	8,307	1,276
SBA	-	-	-	-
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	799	-	799	16
Other	-	-	-	-
Land and land development	3,161	-	3,161	63
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 7,871</u>	<u>\$ 4,497</u>	<u>\$ 12,368</u>	<u>\$ 1,358</u>

TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal and/or interest due, or acceptance of real estate or other assets in full or partial satisfaction of the debt. Loan modifications are not reported as TDR's after 12 months if the loan was modified at a market rate of interest for comparable risk loans, and the loan is performing in accordance with the terms of the restructured agreement for at least six months.

When a loan is modified as a TDR, there may be a direct, material impact on the loans within the Balance Sheet, as principal balances may be partially forgiven. There were no new TDR's for the three month periods ending March 31, 2013 and March 31, 2012.

Loans that were non-accrual prior to modification remain on non-accrual for at least six months following modification. Non-accrual TDR loans that have performed according to the modified terms for six months may be returned to accruing status. Loans that were accruing prior to modification remain on accrual status after the modification as long as the loan continues to perform under the new terms.

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

	Three Months Ended	
	March 31,	
	2013	2012
Interest income that would have been recorded	\$ 190	\$ 185
Interest income recorded	82	83
Effect on interest income	<u>\$ 108</u>	<u>\$ 102</u>

The amount of additional funds committed to borrowers who are in TDR status was \$232 thousand at March 31, 2013 and \$232 thousand at March 31, 2012.

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

The Bank had \$0 loans that were restructured within the 12 months preceding March 31, 2013 and March 31, 2012 and defaulted during the three months ended March 31, 2013 and March 31, 2012.

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 March 31,	
	2013	2012
Balance, beginning of period	\$ 5,131	\$ 10,145
Transfers from nonperforming loans	-	-
Real estate sold	(1,795)	-
Net gains (losses) on sale of assets	-	-
Provision	-	(700)
Balance, end of period	<u>\$ 3,336</u>	<u>\$ 9,445</u>

	March 31, 2013	December 31, 2012
Other real estate	\$ 4,931	\$ 8,146
Valuation allowance	(1,595)	(3,015)
Other real estate, net	<u>\$ 3,336</u>	<u>\$ 5,131</u>

NOTE 7 – Earnings Per Share

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

	Three months ended March 31, 2013	Three months ended March 31, 2012
Denominator for basic earnings per share:		
Average common shares outstanding	3,297,352	3,291,907
Dilutive effect of stock compensation	169,532	20,298
Denominator for diluted earnings per share	<u>3,466,884</u>	<u>3,312,205</u>
Numerator (in thousands):		
Net income	\$ 3,785	\$ 1,568
Preferred stock costs	(324)	(358)
Net income available to common shareholders	<u>\$ 3,461</u>	<u>\$ 1,210</u>
Basic earnings per common share	<u>\$ 1.05</u>	<u>\$ 0.37</u>
Diluted earnings per common share	<u>\$ 1.00</u>	<u>\$ 0.37</u>

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
Total Shares in Plan	250,000	125,000	200,000	250,000	825,000
Total Shares Available	87,951	-	15,850	250,000	353,801
Maximum Restricted Shares Available	87,951	-	15,850	35,000	138,801

The Company granted 240,000 stock options in March of 2010. The stock options vested in March 2012 and can be exercised until March 2020. The exercise price is equal to the market price on grant date, which was \$3.00. The fair value of each share option was 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 \$0 for the three month period ending March 31, 2013 relating to share options. The Company recognized share-based compensation expense of \$29,000 for the three month period ended March 31, 2012 related to share options. At March 31, 2013, the Company had \$0 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 March 31, 2013:

	<u>Stock Options Outstanding</u>	<u>Stock Options Currently Exercisable</u>	<u>Stock Options Vested and Expected to Vest</u>
Number	228,000	228,000	228,000
Weighted-average exercise price	\$3.00	\$3.00	\$3.00
Weighted-average remaining contractual term	6.96	6.96	6.96

The Company recognized share-based compensation expense of \$1,000 related to restricted stock for the three month period ended March 31, 2013. The Company recognized share-based compensation expense of \$8,000 related to restricted stock for the three month period ended March 31, 2012.

At March 31, 2013, the Company had \$2,000 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 March 31, 2013 or December 31, 2012. The carrying amount of available-for-sale securities and their approximate fair values were as follows (in thousands):

	As of March 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	\$ 33,563	\$ 1,263	\$ (178)	\$ 34,648
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC	28,330	85	(423)	27,992
U.S. government agency small business administration pools guaranteed by SBA	41,202	131	(95)	41,238
Collateralized mortgage obligations guaranteed by GNMA/VA	128,782	1,736	(591)	129,927
Collateralized mortgage obligations issued by FNMA or FHLMC	43,104	341	(426)	43,019
Other collateralized mortgage obligations	3,838	55	(3)	3,890
State and municipal bonds	35,772	3,002	-	38,774
	<u>\$ 314,591</u>	<u>\$ 6,613</u>	<u>\$ (1,716)</u>	<u>\$ 319,488</u>
	As of December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	\$ 60,673	\$ 3,007	\$ (93)	\$ 63,587
U.S. government agency mortgage-backed securities issued by FNMA	20,727	188	(307)	20,608
U.S. government agency small business administration pools guaranteed by SBA	13,498	87	(31)	13,554
Collateralized mortgage obligations guaranteed by GNMA/VA	122,404	1,319	(708)	123,015
Collateralized mortgage obligations issued by FNMA or FHLMC	36,167	342	(98)	36,411
Other collateralized mortgage obligations	4,656	148	(1)	4,803
State and municipal bonds	35,944	2,646	(19)	38,571
	<u>\$ 294,069</u>	<u>\$ 7,737</u>	<u>\$ (1,257)</u>	<u>\$ 300,549</u>

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at March 31, 2013 were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ -	\$ -
Due after one year through five years	135	136
Due after five years through ten years	15,636	16,106
Due after ten years	298,820	303,246
Total	\$ 314,591	\$ 319,488

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):

Description of Securities	March 31, 2013								
	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	1	\$ 9,204	\$ (178)	-	\$ -	\$ -	1	\$ 9,204	\$ (178)
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC	3	14,048	(421)	1	53	(2)	4	14,101	(423)
U.S. government agency small business administration pools guaranteed by SBA	6	13,541	(95)	-	-	-	6	13,541	(95)
Collateralized mortgage obligations guaranteed by GNMA/VA	5	22,716	(478)	4	15,266	(113)	9	37,982	(591)
Collateralized mortgage obligations issued by FNMA or FHLMC	3	19,100	(402)	1	2,275	(24)	4	21,375	(426)
Other collateralized mortgage obligations	1	451	(3)	-	-	-	1	451	(3)
State and municipal bonds	-	-	-	-	-	-	-	-	-
Total temporarily impaired securities	<u>19</u>	<u>\$ 79,060</u>	<u>\$ (1,577)</u>	<u>6</u>	<u>\$ 17,594</u>	<u>\$ (139)</u>	<u>25</u>	<u>\$ 96,654</u>	<u>\$ (1,716)</u>

Description of Securities	December 31, 2012								
	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	\$ 9,238	\$ (93)	-	\$ -	\$ -	2	\$ 9,238	\$ (93)
U.S. government agency mortgage-backed securities issued by FNMA	2	15,398	(304)	1	53	(3)	3	15,451	(307)
U.S. government agency small business administration pools guaranteed by SBA	1	3,348	(31)	-	-	-	1	3,348	(31)
Collateralized mortgage obligations guaranteed by GNMA/VA	6	36,023	(329)	4	16,601	(379)	10	52,624	(708)
Collateralized mortgage obligations issued by FNMA or FHLMC	2	8,498	(98)	-	-	-	2	8,498	(98)
Other collateralized mortgage obligations	1	602	(1)	-	-	-	1	602	(1)
State and municipal bonds	2	4,103	(19)	-	-	-	2	4,103	(19)
Total temporarily impaired securities	<u>16</u>	<u>\$ 77,210</u>	<u>\$ (875)</u>	<u>5</u>	<u>\$ 16,654</u>	<u>\$ (382)</u>	<u>21</u>	<u>\$ 93,864</u>	<u>\$ (1,257)</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.

There were no securities that management concluded were other-than-temporarily impaired at March 31, 2013 or December 31, 2012.

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.

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.

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 March 31, 2013				Three Months Ended
	Total	Level 1	Level 2	Level 3	March 31, 2013
					Total gains/(losses)
ASSETS					
Securities available for sale	\$ 319,488	\$ -	\$ 319,488	\$ -	\$ 1,210
Loans held for sale	66,037	-	66,037	-	125
Commitments to originate mortgage loans	3,052	-	3,052	-	(377)
Total assets at fair value	<u>\$ 388,577</u>	<u>\$ -</u>	<u>\$ 388,577</u>	<u>\$ -</u>	<u>\$ 958</u>
LIABILITIES					
Commitments to sell mortgage loans	\$ 67	\$ -	\$ 67	\$ -	\$ -
Mortgage banking short positions	163	-	163	-	(111)
Total liabilities at fair value	<u>\$ 230</u>	<u>\$ -</u>	<u>\$ 230</u>	<u>\$ -</u>	<u>\$ (111)</u>

	Carrying Value at December 31, 2012				Twelve Months Ended December 31, 2012
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Securities available for sale	\$ 300,549	\$ -	\$ 300,549	\$ -	\$ -
Loans held for sale	95,095	-	95,095	-	649
Commitments to originate mortgage loans	4,499	-	4,499	-	2,183
Total assets at fair value	<u>\$ 400,143</u>	<u>\$ -</u>	<u>\$ 400,143</u>	<u>\$ -</u>	<u>\$ 2,832</u>
LIABILITIES					
Commitments to sell mortgage loans	\$ 2,233	\$ -	\$ 2,233	\$ -	\$ 2,143
Mortgage banking short positions	52	-	52	-	(52)
Total liabilities at fair value	<u>\$ 2,285</u>	<u>\$ -</u>	<u>\$ 2,285</u>	<u>\$ -</u>	<u>\$ 2,091</u>

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 March 31, 2013				Three Months Ended March 31, 2013
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 8,455	\$ -	\$ 8,455	\$ -	\$ 134
Other real estate ⁽²⁾	3,336	-	3,336	-	-
Total	<u>\$ 11,791</u>	<u>\$ -</u>	<u>\$ 11,791</u>	<u>\$ -</u>	<u>\$ 134</u>
	Carrying Value at December 31, 2012				Twelve Months Ended December 31, 2012
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 8,394	\$ -	\$ 8,394	\$ -	\$ (1,431)
Other real estate ⁽²⁾	5,131	-	5,131	-	(1,808)
Total	<u>\$ 13,525</u>	<u>\$ -</u>	<u>\$ 13,525</u>	<u>\$ -</u>	<u>\$ (3,239)</u>

(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):

	Level in Fair Value Measurement Hierarchy	March 31, 2013		December 31, 2012	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	\$ 89,534	\$ 89,534	\$ 40,790	\$ 40,790
Investment securities available for sale	Level 2	319,488	319,488	300,549	300,549
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	2,602	2,602	2,601	2,601
Loans held for sale-mortgage banking	Level 2	66,037	66,037	95,095	95,095
Commitments to originate mortgage loans	Level 2	3,052	3,052	4,499	4,499
Loans and leases held for investment, net	Level 2	273,076	276,863	279,378	278,705
Accrued interest receivable	Level 2	2,545	2,545	2,590	2,590
		<u>\$ 756,334</u>	<u>\$ 760,121</u>	<u>\$ 725,502</u>	<u>\$ 724,829</u>
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	\$ 106,238	\$ 106,238	\$ 131,593	\$ 131,593
Deposits, interest-bearing	Level 2	575,474	577,182	518,011	520,795
Borrowings and advances	Level 2	16,098	16,098	11,700	11,700
Accrued interest payable	Level 2	478	478	5,045	5,045
Accrued expenses	Level 2	5,625	5,625	10,144	10,144
Commitments to sell mortgage loans	Level 2	67	67	2,233	2,233
Mortgage banking short positions	Level 2	163	163	52	52
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	22,430	15,083	22,430	14,849
		<u>\$ 726,573</u>	<u>\$ 720,934</u>	<u>\$ 701,208</u>	<u>\$ 696,411</u>
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit Standby and commercial letters of credit	Level 2	\$ -	\$ 67	\$ -	\$ 94
	Level 2	\$ -	\$ 16	\$ -	\$ 14

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 the holding company named BNCCORP, INC.; (the Bank) when referring only to BNC National Bank.

Comparison of Results for the Three Months Ended March 31, 2013 and 2012

Summary for the Three Months Ended March 31, 2013 and 2012

Net income was \$3.785 million and the net income available to common shareholders was \$3.461 million, or \$1.00 per share on a diluted basis, for the quarter ended March 31, 2013. This compared to net income of \$1.568 million and net income available to common shareholders of \$1.210 million, or \$0.37 per diluted share, in the first quarter of 2012.

Net interest income for the first quarter of 2013 was \$4.633 million, a decrease of \$12 thousand, or 0.3%, from \$4.645 million in the same period of 2012. The net interest margin for the current period decreased to 2.61% from 3.00%.

In the first quarter of 2013 and 2012, the Company's provision for credit losses was \$700 thousand and \$100 thousand, respectively.

Non-interest income for the first quarter of 2013 was \$11.324 million. This compares to non-interest income of \$5.697 million for the same period in 2012, an increase of \$5.627 million, or 98.8%.

Non-interest expense for the first quarter of 2013 was \$9.397 million compared to \$8.672 million in the same period of 2012, an increase of \$725 thousand, or 8.4%.

In the first quarter of 2013, we recorded tax expense of \$2.075 million which resulted in an effective tax rate of 35.4% for the quarter. A tax expense of \$2 thousand was recognized during the first quarter of 2012.

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 March 31,								
	2013			2012			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	\$ 60,826	\$ 26	0.17%	\$ 33,530	\$ 16	0.19%	\$ 27,296	\$ 10	-0.02%(a)
Investments - taxable	267,711	1,341	2.03%	222,200	1,709	3.09%	45,511	(368)	-1.06%(b)
Investments - tax exempt	38,238	282	2.99%	24,983	206	3.32%	13,255	76	-0.33%(b)
Loans held for sale – mortgage banking	78,572	595	3.07%	62,598	567	3.64%	15,974	28	-0.57%(c)
Loans and leases held for investment	285,110	3,405	4.84%	289,426	3,633	5.05%	(4,316)	(228)	-0.21%(d)
Allowance for loan losses	(10,066)	-		(10,701)	-		635	-	
Total interest-earning assets	<u>\$ 720,391</u>	<u>\$ 5,649</u>	3.18%	<u>\$ 622,036</u>	<u>\$ 6,131</u>	3.96%	<u>\$ 98,355</u>	<u>\$ (482)</u>	-0.78%
Interest-bearing liabilities									
Interest checking and money market	\$ 326,262	\$ 169	0.21%	\$ 265,993	\$ 181	0.27%	\$ 60,269	\$ (12)	-0.06%(e)
Savings	18,323	5	0.11%	14,348	4	0.11%	3,975	1	0.00%
Certificates of deposit under \$100,000	127,603	392	1.25%	128,579	697	2.18%	(976)	(305)	-0.93%(e)
Certificates of deposit \$100,000 and over	79,300	150	0.77%	61,566	213	1.39%	17,734	(63)	-0.62%(e)
Total interest-bearing deposits	551,488	716	0.53%	470,486	1,095	0.94%	81,002	(379)	-0.41%
Short-term borrowings	14,826	10	0.27%	9,736	18	0.74%	5,090	(8)	-0.47%(f)
Federal Home Loan Bank advances	-	-	0.00%	1	-	0.00%	(1)	-	0.00%
Subordinated debentures	22,430	290	5.24%	22,427	373	6.69%	3	(83)	-1.45%
Total borrowings	37,256	300	3.27%	32,164	391	4.89%	5,092	(91)	-1.62%
Total interest-bearing liabilities	<u>\$ 588,744</u>	<u>1,016</u>	0.70%	<u>\$ 502,650</u>	<u>1,486</u>	1.19%	<u>\$ 86,094</u>	<u>(470)</u>	-0.49%
Net interest income/spread		<u>\$ 4,633</u>	2.48%		<u>\$ 4,645</u>	2.77%		<u>\$ (12)</u>	-0.29%
Net interest margin			2.61%			3.00%			-0.39%
Notation:									
Non-interest-bearing deposits	<u>\$ 112,131</u>	-		<u>\$ 120,161</u>	-		<u>\$ (8,030)</u>	-	(f)
Total deposits	<u>\$ 663,619</u>	<u>\$ 716</u>	0.44%	<u>\$ 590,647</u>	<u>\$ 1,095</u>	0.75%	<u>\$ 72,972</u>	<u>\$ (379)</u>	-0.31%
Taxable equivalents:									
Total interest-earning assets	\$ 720,391	\$ 5,804	3.27%	\$ 622,036	\$ 6,240	4.03%	\$ 98,355	\$ (436)	-0.76%
Net interest income/spread	-	\$ 4,788	2.57%	-	\$ 4,754	2.84%	-	\$ 34	-0.27%
Net interest margin	-	-	2.70%	-	-	3.07%	-	-	-0.37%

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

- Loans held for sale declined in the current quarter and cash increased as we are prudently deploying cash.
- Investment growth has been funded by an increase in deposits.
- While loans held for sale increased throughout most of 2012, the balances have decreased since the beginning of 2013. The balance of loans held for sale can vary depending on the volume of loans originated and efficiency with which the loans are sold.
- The balance of loans has declined due to repayments, sales and charge-offs. In recent years we have been reducing exposure to credit risk. Due to the pipeline of activity, we are optimistic that loans may grow later in the year.
- Checking and money market deposits can vary due depending on the cash needs of our customers; our balances in these accounts have increased due to growth, primarily in North Dakota.
- Short term borrowings will vary depending on our customers need to use repurchase agreements.

Non-interest Income

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

	Three Months Ended			
	March 31,		Increase (Decrease)	
	2013	2012	\$	%
Bank charges and service fees	\$ 617	\$ 563	\$ 54	10 %
Wealth management revenues	327	351	(24)	(7) %
Mortgage banking revenues	8,247	4,247	4,000	94 % (a)
Gains on sales of loans, net	755	338	417	123 % (b)
Gains on sales of securities, net	1,210	-	1,210	100 % (c)
Other	168	198	(30)	(15) %
Total non-interest income	<u>\$ 11,324</u>	<u>\$ 5,697</u>	<u>\$ 5,627</u>	99 %

- (a) The increase is due to the low interest rate environment that favors mortgage banking. In the near term, we expect mortgage banking revenues to be elevated. In the longer term, the amount of revenues is uncertain.
- (b) Gains and losses on sales will vary significantly from period to period. The secondary market for SBA loans is currently acquisitive and loans can be sold at attractive prices.
- (c) Gains and losses on sales will vary significantly from period to period.

Non-interest Expense

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

	Three Months Ended			
	March 31,		Increase (Decrease)	
	2013	2012	\$	%
Salaries and employee benefits	\$ 5,035	\$ 3,713	\$ 1,322	36 % (a)
Professional services	969	973	(4)	- %
Data processing fees	720	669	51	8 %
Marketing and promotion	509	406	103	25 %
Occupancy	518	495	23	5 %
Regulatory costs	324	293	31	11 %
Depreciation and amortization	305	278	27	10 %
Office supplies and postage	155	180	(25)	(14) %
Other real estate costs	77	828	(751)	(91) % (b)
Other	785	837	(52)	(6) %
Total non-interest expense	<u>\$ 9,397</u>	<u>\$ 8,672</u>	<u>\$ 725</u>	8 %
Efficiency ratio	<u>58.9%</u>	<u>83.9%</u>		

- (a) Salaries have increased due to higher FTE's, merit increases and accrued incentives for producers.
- (b) Other real estate costs will vary from period to period depending on valuation adjustments on our foreclosed properties— see Note 8. In the first quarter of 2013, costs related to valuation allowances decreased as values of foreclosed properties stabilized.

Income Taxes

In the first quarter of 2013, we recorded tax expense of \$2.075 million which resulted in an effective tax rate of 35.4% for the quarter. A tax expense of \$2 thousand was recognized during the first quarter of 2012.

Comparison of Financial Condition at March 31, 2013 and December 31, 2012

Assets

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

	March 31,	December 31,	Increase (Decrease)		
	2013	2012	\$	%	
Cash and cash equivalents	\$ 89,534	\$ 40,790	\$ 48,744	119 %	(a)
Investment securities available for sale	319,488	300,549	18,939	6 %	(b)
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	2,602	2,601	1	- %	
Loans held for sale-mortgage banking	66,037	95,095	(29,058)	(31) %	(c)
Loans and leases held for investment, net	273,076	279,378	(6,302)	(2) %	(d)
Other real estate, net	3,336	5,131	(1,795)	(35) %	(e)
Premises and equipment, net	16,160	15,932	228	1 %	
Accrued interest receivable	2,545	2,590	(45)	(2) %	
Other assets	26,622	28,710	(2,088)	(7) %	(f)
Total assets	\$ 799,400	\$ 770,776	\$ 28,624	4 %	

- (a) Loans held for sale decreased in the most recent quarter and resulting cash has been deployed prudently. Cash balances can vary from period to period, but we generally emphasize liquidity.
- (b) The increase in investments has primarily been funded by deposit growth.
- (c) While loans held for sale have decreased in the recent quarter, low interest rates have favored mortgage banking.
- (d) Loans held for investment have decreased as our growth in North Dakota has been offset by repayments and other measures we have implemented to reduce our exposure to credit risk within certain segments. Due to the pipeline of activity, we are cautiously optimistic loans may grow later in 2013.
- (e) Decrease is due to sales of foreclosed assets.
- (f) Other assets went down primarily due to a decrease in the fair value of mortgage banking derivatives and tax assets.

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. Loan participations sold on a nonrecourse basis to outside financial institutions were \$215.6 million as of March 31, 2013 and \$218.1 million as of December 31, 2012. The sales of participations are accounted for pursuant to FASB ASC 860, *Transfers and Servicing*.

Concentrations of Credit

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

	<u>March 31, 2013</u>			<u>December 31, 2012</u>		
North Dakota	\$ 172,368	61	%	\$ 176,653	61	%
Minnesota	33,247	12		38,188	13	
Arizona	30,199	11		29,238	10	
Other	47,098	16		45,386	16	
Total gross loans held for investment	<u>\$ 282,912</u>	<u>100</u>	<u>%</u>	<u>\$ 289,465</u>	<u>100</u>	<u>%</u>

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 (dollars are in thousands):

	<u>March 31, 2013</u>			<u>December 31, 2012</u>		
North Dakota	\$ 176,986	63	%	\$ 168,198	58	%
Arizona	40,467	14		40,215	14	
California	16,908	6		22,088	8	
Minnesota	14,324	5		17,561	6	
Colorado	8,987	3		7,686	3	
Other	25,240	9		33,717	11	
Total gross loans held for investment	<u>\$ 282,912</u>	<u>100</u>	<u>%</u>	<u>\$ 289,465</u>	<u>100</u>	<u>%</u>

Loan Maturities⁽¹⁾

The following table sets forth the remaining maturities of loans in each major category of our portfolio as of March 31, 2013 (in thousands):

	Over 1 year through 5 years			Over 5 years		Total Loans and Leases Held for Investment
	One year or less	Fixed Rate	Floating Rate	Fixed Rate	Floating rate	
Commercial and industrial	\$ 48,564	\$ 45,417	\$ 6,848	\$ 16,913	\$ 4,825	\$ 122,567
Commercial real estate	37,353	18,101	6,770	7,370	2,722	72,316
SBA	1,040	143	1,160	1,121	12,930	16,394
Consumer	2,145	15,809	3,369	5,527	213	27,063
Land and land development	10,671	6,353	8,477	1,078	2,791	29,370
Construction	1,479	-	-	7,563	6,160	15,202
Total principal amount of loans	<u>\$ 101,252</u>	<u>\$ 85,823</u>	<u>\$ 26,624</u>	<u>\$ 39,572</u>	<u>\$ 29,641</u>	<u>\$ 282,912</u>

(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.

Allocation of the Allowance for Loan Losses

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 (dollars are in thousands).

	March 31, 2013		December 31, 2012	
	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment
Commercial and industrial	\$ 2,072	43%	\$ 2,546	40%
Commercial real estate	4,507	26%	4,790	30%
SBA	712	6%	616	6%
Consumer	448	10%	382	9%
Land and land development	1,926	10%	1,609	11%
Construction	208	5%	148	4%
Total	<u>\$ 9,873</u>	<u>100%</u>	<u>\$ 10,091</u>	<u>100%</u>

We do not originate sub-prime single family loans. We do have land, construction, and commercial real estate loans in our portfolio. 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 (in thousands):

	Three Months Ended		Twelve Months Ended
	March 31,		December 31,
	2013	2012	2012
Balance, beginning of period	\$ 10,512	\$ 6,169	\$ 6,169
Additions to nonperforming	725	1	5,880
Charge-offs	(894)	(300)	(354)
Reclassified back to performing	-	(815)	(815)
Principal payment received	(73)	(42)	(368)
Transferred to other real estate owned	-	-	-
Balance, end of period	<u>\$ 10,270</u>	<u>\$ 5,013</u>	<u>\$ 10,512</u>

Nonperforming Assets

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

	March 31,	December 31,
	2013	2012
Nonperforming loans:		
Loans 90 days or more delinquent and still accruing interest	\$ 41	\$ 12
Non-accrual loans	10,229	10,500
Total nonperforming loans	<u>10,270</u>	<u>10,512</u>
Other real estate, net	3,336	5,131
Total nonperforming assets	<u>\$ 13,606</u>	<u>\$ 15,643</u>
Allowance for credit losses	<u>\$ 9,873</u>	<u>\$ 10,091</u>
Ratio of total nonperforming loans to total loans	2.94%	2.73%
Ratio of total nonperforming loans to loans and leases held for investment	3.63%	3.63%
Ratio of total nonperforming assets to total assets	1.70%	2.03%
Ratio of nonperforming loans to total assets	1.28%	1.36%
Ratio of allowance for credit losses to nonperforming loans	96%	96%

Potential Problem Loans

The macroeconomic environment has recently been challenging. As long as these conditions persist, many loans are potentially problematic assets.

Notwithstanding the prior paragraph, we attempt to quantify potential problem loans with more immediate credit risk. At March 31, 2013, the Bank had \$13.8 million of classified loans and \$10.2 million of loans on non-accrual. This compares to \$13.6 million of classified loans and \$10.5 million of loans on non-accrual at December 31, 2012 and \$21.1 million of classified loans and \$5.0 million of loans on non-accrual at March 31, 2012. We estimate there are loans risk rated “watch list” which are not impaired aggregating \$791 thousand at March 31, 2013 and \$5.2 million at December 31, 2012. Also, we estimate there are loans risk rated “substandard” which are not impaired aggregating \$3.0 million at March 31, 2013 and \$3.1 million at December 31, 2012.

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	March 31,	December 31,	Increase (Decrease)	
	2013	2012	\$	%
Deposits:				
Non-interest-bearing	\$ 106,238	\$ 131,593	\$ (25,355)	(19) % (a)
Interest-bearing-				
Savings, interest checking and money market	372,679	313,051	59,628	19 % (a)
Time deposits under \$100,000	126,070	128,150	(2,080)	(2) % (a)
Time deposits \$100,000 and over	76,725	76,810	(85)	- % (a)
Short-term borrowings	16,098	11,700	4,398	38 % (b)
Guaranteed preferred beneficial interests in Company's subordinated debentures	22,430	22,430	-	- %
Accrued interest payable	478	5,045	(4,567)	(91) %
Accrued expenses	5,625	10,144	(4,519)	(45) % (c)
Other liabilities	1,797	3,123	(1,326)	(42) % (d)
Total liabilities	\$ 728,140	\$ 702,046	\$ 26,094	4 %

(a) Total deposits have increased primarily due to growth in our North Dakota branches.

(b) Short term borrowings will vary depending on our customers need to use repurchase agreements.

(c) Accrued expenses decreased due to payments made on interest and dividend obligations that were deferred until the first quarter of 2013.

(d) Other liabilities decreased due to a reduction in mortgage banking derivatives.

Mortgage Banking Obligations

Through its mortgage banking operations, the Company originates and sells residential mortgage loans servicing released to third parties. These loans are sold without recourse to the Bank. However, standard industry practices require representations and warranties which generally require sellers to reimburse a portion of the sales proceeds if a sold loan defaults or pays off shortly after the sale of the loan (i.e. generally within four months of the sale.) In addition, disputes regarding industry practices are becoming relatively common in recent years. The following is a summary of activity related to mortgage banking obligations (in thousands):

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012	Twelve Months Ended December 31, 2012
Balance, beginning of period	\$ 1,500	\$ 800	\$ 800
Provision	202	164	849
Write offs, net	(88)	(77)	(149)
Balance, end of period	\$ 1,614	\$ 887	\$ 1,500

Stockholders' Equity

Our stockholders' equity increased \$2.5 million between December 31, 2012 and March 31, 2013 primarily due to earnings and 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 defined 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 as needed basis, but no less frequently than monthly. We measure our liquidity position using the total of the following items:

1. Estimated liquid assets less estimated volatile liabilities using the aforementioned methodology (\$251.3 million as of March 31, 2013);
2. Borrowing capacity from the FHLB (\$45.4 million as of March 31, 2013); and
3. Capacity to issue brokered deposits with maturities of less than 12 months (\$110.2 million as of March 31, 2013).

On an on-going basis, we use a variety of factors to assess our liquidity position including, but not limited to, the following items:

- Stability of our deposit base,
- Amount of pledged investments,
- Amount of unpledged investments,
- Liquidity of our loan portfolio, and
- Potential loan demand.

Our liquidity assessment process segregates our balance sheet into liquid assets and short-term liabilities assumed to be vulnerable to non-replacement over a 30 day horizon in abnormally stringent conditions. Assumptions for the vulnerable short-term liabilities are based upon historical factors. We have a targeted range for our liquidity position over this horizon and manage operations to achieve these targets.

We further project cash flows over a 12 month horizon based on our assets and liabilities and sources and uses of funds for anticipated events.

Pursuant to our contingency funding plan, we also estimate cash flows over a 12 month horizon under a variety of stressed scenarios to identify potential funding needs and funding sources. Our contingency plan identifies actions that could be taken in response to adverse liquidity events.

We believe this process, combined with our policies and guidelines, should provide for adequate levels of liquidity to fund the anticipated needs of on- and off- balance sheet items.

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. 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. See Note 1 of our Consolidated Financial Statements for a summary of our accounting policies pertaining to such instruments.

Our primary tool for measuring and managing interest rate risk is net interest income simulation. This exercise includes our assumptions regarding the changes in interest rates and the impact on our current balance sheet. Interest rate caps and floors are included to the extent that they are exercised in the 12-month simulation period. Additionally, changes in prepayment behavior of the residential mortgage, CMOs, and mortgage-backed securities portfolios in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. For purposes of this simulation, projected month end balances of the various balance sheet accounts are held constant at their March 31, 2013 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 March 31, 2013 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 March 31, 2013, 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	\$ 17,567	\$ 18,638	\$ 19,008	\$ 19,291	\$ 19,568	\$ 19,805
Dollar change from unchanged scenario	\$ (1,071)	\$ -	\$ 370	\$ 653	\$ 930	\$ 1,167
Percentage change from unchanged scenario	-5.75%	-	1.99%	3.50%	4.99%	6.26%

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 March 31, 2013 (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 March 31, 2013. 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 March 31, 2013

	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	\$ 89,534	\$ -	\$ -	\$ -	\$ 89,534
Investment securities (a)	46,222	33,205	115,246	95,157	289,830
FRB and FHLB stock	2,602	-	-	-	2,602
Fed funds sold	-	-	-	-	-
Loans held for sale-mortgage banking, fixed rate	-	66,037	-	-	66,037
Loans held for sale-mortgage banking, floating rate	-	-	-	-	-
Loans held for investment, fixed rate	26,409	27,110	78,797	24,528	156,844
Loans held for investment, floating rate	111,997	5,206	6,624	2,278	126,105
Total interest-earning assets	<u>\$ 276,764</u>	<u>\$ 131,558</u>	<u>\$ 200,667</u>	<u>\$ 121,963</u>	<u>\$ 730,952</u>
Interest-bearing liabilities:					
Interest checking and money market accounts	\$ 353,177	\$ -	\$ -	\$ -	\$ 353,177
Savings	19,502	-	-	-	19,502
Time deposits under \$100,000	11,621	32,364	41,685	40,400	126,070
Time deposits \$100,000 and over	15,845	45,101	15,428	351	76,725
Short-term borrowings	16,098	-	-	-	16,098
FHLB advances	-	-	-	-	-
Other borrowing	-	-	-	-	-
Subordinated debentures	15,000	-	-	7,430	22,430
Total interest-bearing liabilities	<u>\$ 431,243</u>	<u>\$ 77,465</u>	<u>\$ 57,113</u>	<u>\$ 48,181</u>	<u>\$ 614,002</u>
Interest rate gap	<u>\$ (154,479)</u>	<u>\$ 54,093</u>	<u>\$ 143,554</u>	<u>\$ 73,782</u>	<u>\$ 116,950</u>
Cumulative interest rate gap at March 31, 2013	<u>\$ (154,479)</u>	<u>\$ (100,386)</u>	<u>\$ 43,168</u>	<u>\$ 116,950</u>	
Cumulative interest rate gap to total assets	(19.32%)	(12.56%)	5.40%	14.63%	

(a) Values for investment securities reflect the timing of the estimated principal cash flows from the securities based on par values, which vary from the amortized cost and fair value of our investments.

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 March 31, 2013 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.

Signatures

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

BNCCORP, INC.

Date: May 15, 2013

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

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