McGladrey & Pullen Certified Public Accountants

Independent Auditor's Report

To the Shareholders and Board of Directors
Independent Bankers Financial Corporation and Subsidiaries
Irving, Texas

We have audited the accompanying consolidated balance sheets of Independent Bankers Financial Corporation and Subsidiaries (the Corporation) as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Independent Bankers Financial Corporation and Subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have examined, in accordance with attestation standards established by the American Institute of Certified Public Accountants, the internal control over financial reporting of TIB-The Independent BankersBank (the Bank), a wholly owned subsidiary of the Corporation, as of December 31, 2008 and our report dated March 25, 2009 expressed an unqualified opinion on the effectiveness of the Bank's internal control over financial reporting.

McGladrey & Pullen, LLP

Dallas, Texas
March 25, 2009

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Balance Sheets
at December 31, 2008 and 2007
(Dollar Amounts in Thousands, except per share amounts)

ASSETS	2008	2007
Cash due from banks	$ 13,706	$ 23,453
Interest-bearing deposits	219,525	517
Federal funds sold and securities purchased under agreements to resell	197,385	720,458
Total cash equivalents	430,616	744,428
Interest-bearing time deposits	-	100
Securities available for sale	623,322	228,261
Loans held for sale	30,854	54,042
Loans, net	829,553	724,070
Premises and equipment, net	5,139	4,864
Other real estate owned, net	30	3,460
Mortgage servicing rights	20,539	30,756
Accrued interest receivable	8,399	7,680
Due from broker	16,721	9,789
Cash surrender value of life insurance	23,335	22,462
Intangible assets, net	2,298	3,546
Other assets	54,141	29,571
Total assets	$ 2,044,947	$ 1,863,029
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$ 236,895	$ 172,756
Interest-bearing	20,050	230,745
Total deposits	256,945	403,501
Federal funds purchased and securities sold under agreements to repurchase	1,384,961	1,244,708
Accrued interest payable and other liabilities	61,599	35,065
Other borrowings	200,000	50,000
Junior subordinated debentures	30,928	30,928
Total liabilities	1,934,433	1,764,202
Commitments and contingencies		-
Shareholders' equity:		
Common stock, par value $10 per share, 5,000,000 shares authorized, 1,118,250 and 1,091,796 shares issued and outstanding in 2008 and 2007	11,182	10,918
Capital surplus	25,838	23,391
Retained earnings	81,199	67,953
Accumulated other comprehensive loss	(7,705)	$ (3,435)
Total shareholders' equity	110,514	98,827
Total liabilities and shareholders' equity	$ 2,044,947	$ 1,863,029

See Notes to
Consolidated Financial Statements.

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Statement of Income for the Years Ended December 31, 2008 and 2007

(Dollar Amounts in Thousands)

	2008	2007
Interest income:		
Loans, including fees - taxable	$ 37,158	$ 46,887
Loans , including fees - tax exempt	8,033	6,226
Securities - taxable	14,026	11,918
Federal funds sold and repurchase agreements	12,752	35,388
Other	1,195	458
Total interest income	73,164	100,877
Interest expense:		
Deposits	3,128	13,438
Federal funds purchased and repurchase agreements	30,002	59,860
Junior subordinated debentures and other borrowings	6,631	3,736
Total interest expense	39,761	77,034
Net interest income	33,403	23,843
Provision for loan losses	9,951	2,754
Net interest income after provision for loan losses	23,452	21,089
Noninterest income	119,592	93,465
Noninterest expense:		
Salaries and benefits	36,210	31,015
Premises, furniture and equipment	3,032	2,965
Telephone expense	1,384	1,283
Software maintenance	1,743	1,303
Credit card expenses	44,250	39,646
Mortgage operation expense	3,374	1,532
Increase in valuation allowance for mortgage servicing rights	19,720	10,146
Item processing expense	1,279	1,774
Intangible amortization	1,248	1,248
Professional fees	1,613	1,354
Other operating expenses	10,084	8,954
Total noninterest expense	123,937	101,220
Income before income taxes	19,107	13,334
Federal income taxes:		
Current expense	8,753	2,246
Deferred (benefit) expense	(4,682)	580
	4,071	2,826
Net income	$ 15,036	$ 10,508

See Notes to
Consolidated Financial Statements.

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2008 and 2007

(Dollar Amounts in Thousands , except per share amounts)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at January 1, 2007	$ 10,858	$ 21,005	$ 59,082	$ (3,765)	$ 87,180
Comprehensive income:					
Net income	-	-	10,508	-	10,508
Change in fair value of securities available for sale, net of reclassification adjustment of $47 and tax effect of $1,617	-	-	-	3,138	3,138
Change in fair value of Fed Funds Swap, net of reclassification adjustment of $167 and net of tax effect of $(1,446)	-	-	-	(2,808)	(2,808)
Total comprehensive income					10,838
Purchase and retirement of common stock (34,459 shares)	(344)	(748)	-	-	(1,092)
Sale of common stock (40,430 shares)	404	3,134	-	-	3,538
Common stock dividend declared ($1.50 per share)	-	-	(1,637)	-	(1,637)
Balance at December 31, 2007	$ 10,918	$ 23,391	$ 67,953	$ (3,435)	$ 98,827
Comprehensive income:					
Net income	-	-	15,036	-	15,036
Change in fair value of securities available for sale, net of reclassification adjustment of $409 and tax effect of $3,943	-	-	-	7,654	7,654
Change in fair value of Fed Funds Swap, net of tax effect of $(6,143)	-	-	-	(11,924)	(11,924)
Total comprehensive income	-	-	-	-	10,766
Purchase and retirement of common stock (6,441 shares)	(64)	(512)	-	-	(576)
Sale of common stock (32,895 shares)	328	2,959	-	-	3,287
Common stock dividend declared ($1.60 per share)	-	-	(1,790)	-	(1,790)
Balance at December 31, 2008	$ 11,182	$ 25,838	$ 81,199	**$ (7,705)**	$ 110,514

See Notes to Consolidated Financial Statements.

Independent Bankers Financial Corporation and Subsidiaries

Consolidated Statements of Cash Flows for the Years Ended December 31, 2008 and 2007

(Dollar Amounts in Thousands)

	2008	2007
Cash flows from operating activities:		
Net income	$ 15,036	$ 10,508
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,572	4,518
Provision for loan losses	9,951	2,754
Deferred taxes	(4,682)	580
Deferred compensation expense	2,205	1,461
Increase in valuation allowance for mortgage servicing rights	19,720	10,146
Net gain on sale of loans	(4,078)	(2,936)
Net gain on derivative securities	(19,142)	(6,668)
Net gain on sale of other investments	(3,695)	(2,061)
Other	(190)	(321)
Increase in cash surrender value of life insurance	(873)	(837)
Originations and purchases of loans held for sale	(633,854)	(539,242)
Proceeds from sales of loans held for sale	661,007	511,770
Changes in operating assets and liabilities, net of effects of acquisition:		
Accrued interest receivable	(719)	784
Other assets	(17,823)	(7,689)
Accrued interest payable and other liabilities	2,507	8,625
Net cash provided by (used in) operating activities	28,942	(8,608)
Cash flows from investing activities:		
Securities available for sale:		
Purchases	(568,218)	(600)
Proceeds from sales	106,249	30,059
Proceeds from maturities, calls and principal repayments	78,500	119,956
Maturities of interest bearing time deposits	100	200
Proceeds from derivative securities	16,208	-
Proceeds from sale of other investments	3,695	2,061
Purchases of mortgage servicing rights	(9,503)	(8,398)
Net increase in loans	(115,321)	(58,742)
Proceeds from sales of assets	3,320	2,118
Purchases of premises and equipment	(2,555)	(1,122)
Acquisitions, net of cash acquired	-	(1,000)
Net cash provided by (used in) investing activities	(487,525)	84,532
Cash flows from financing activities:		
Net change in deposits	(146,556)	37,525
Net change in federal funds purchased and securities sold under agreements to repurchase	140,253	246,938
Net change in other borrowings	150,000	(50,000)
Purchase and retirement of common stock	(576)	(1,092)
Sale of common stock	3,287	3,538
Dividends paid	(1,637)	(1,521)
Net cash provided by financing activities	144,771	235,388
Net increase (decrease) in cash equivalents	(313,812)	311,312
Cash equivalents at beginning of year	744,428	433,116
Cash equivalents at end of year	$ 430,616	$ 744,428
Supplemental cash flow information:		
Cash paid for interest	$ 39,956	$ 77,391
Cash paid for taxes	4,157	2,207
Real estate acquired in foreclosure or in settlement of loans	-	58

See Notes to Consolidated Financial Statements.

Note 1. Summary of Significant Accounting Policies

The consolidated financial statements of Independent Bankers Financial Corporation and Subsidiaries (Corporation) have been prepared in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of Independent Bankers Financial Corporation (IBFC), IBFC Nevada Corporation, TIB-The Independent BankersBank (Bank), and other nonbanking subsidiaries, including ALX Consulting, Inc., BankersBank Card Services Company (BBCS) and TIB Service Company. In addition, the Corporation wholly-owns IBFC Statutory Capital Trust II. See Note 12 for further discussion regarding the Trust. The Bank is an entity which is defined by statute as a "bankers' bank". The statute requires all of the shareholders of the Bank to be depository institutions or holding companies for depository institutions and that the Bank provide services only for depository institutions or at the request of depository institutions. In this context, the Bank provides various banking and banking-related services to financial institutions primarily in Texas, New Mexico, Oklahoma, Arizona, Louisiana and California, many of which are shareholders of the Corporation.

All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The allowance for loan losses and fair values of mortgage servicing rights and financial instruments are particularly subject to change.

Cash Flow Reporting

Cash equivalents include cash items, amounts due from banks, deposits with other financial institutions that have an initial maturity under 90 days when acquired by the Corporation, federal funds sold, and securities purchased under agreements to resell. Net cash flows are reported for loans, loans held for sale, deposit transactions and short-term borrowings.

Concentrations and Restrictions on Cash Equivalents

The Corporation maintains deposits with other financial institutions in amounts that exceed federal deposit insurance coverage. Furthermore, federal funds sold are essentially uncollateralized loans to other financial institutions. Management regularly evaluates the credit risk associated with the counterparties to these transactions.

The Corporation was required to have $18,453 and $15,029 of cash on deposit with the Federal Reserve Bank to meet regulatory reserve and clearing requirements at December 31, 2008 and 2007, respectively.

Repurchase/Resell Agreements

The Corporation purchases certain securities under agreements to resell. The amounts advanced under these agreements represent short-term loans and are reflected as assets in the accompanying consolidated balance sheet. The securities underlying these agreements are book-entry securities. At December 31, 2008, resell agreements outstanding were $65,892 that mature within 30 days. At December 31, 2007, there were no resell agreements outstanding. The Corporation also sells certain securities under agreements to repurchase. The agreements are treated as financings, and the obligations to repurchase securities sold are reflected as a liability in the accompanying consolidated balance sheet. The dollar amount of securities underlying the agreements remains in the asset accounts. At December 31, 2008 and 2007, repurchase agreements outstanding were $4,100 and $4,900, respectively, and mature within 90 days.

Securities

Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities to be held for indefinite periods of time are classified as available for sale and are carried at fair value, with unrealized holding gains and losses reported as a component of comprehensive income. Management determines the appropriate classification of securities at the time of purchase. Securities with limited marketability, such as stock in the Federal Reserve Bank and Federal Home Loan Bank, are carried at cost.

Interest income includes amortization of purchase premiums and discounts. Realized gains and losses on sales of securities are recorded on the trade date and are determined using the specific identification method. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Loans Held for Sale

The Corporation originates mortgage loans for portfolio investment or sale in the secondary market. During the period of origination, mortgage loans are designated as held either for sale or investment purposes. Mortgage loans held for sale are carried at the lower of cost or market value, determined on a net aggregate basis. Gains or losses recognized upon the sale of loans are determined on a specific identification basis.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding unpaid principal balances adjusted for charge offs and the allowance for loan losses. Interest income is accrued on the unpaid principal balance.

The accrual of interest is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. All interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify such loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Allowance for Loan Losses

The allowance for loan losses is a reserve established through a provision for loan losses charged to an expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans.

The allowance, in the judgment of management, is necessary to reserve for estimated loan losses inherent in the loan portfolio. The allowance for loan losses includes allowance allocations calculated in accordance with Statement of Financial Accounting Standards (''SFAS") No. 114, "Accounting by Creditors for Impairment of a Loan", as amended by SFAS No. 118, and allowance allocations calculated in accordance with SFAS No. 5, "Accounting for Contingencies". The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio, as well as trends in the foregoing. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Corporation's control, including but not limited to the performance of the loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Corporation's allowance for loan losses consists of three elements: (i) specific valuation allowances established for probable losses on specific loans; (ii) historical valuation allowances calculated based on historical loan loss experience for similar loans with similar characteristics and trends; and (iii) unallocated general valuation allowances determined based on general economic conditions and other qualitative risk factors both internal and external to the Corporation.

Premises and Equipment

Land is carried at cost. Building and improvements, and furniture and equipment are carried at cost, less accumulated depreciation computed principally by the straight-line method based on the estimated useful lives of the related properties. Leasehold improvements are generally depreciated over the lesser of the term of the respective leases or the estimated useful lives of the improvements.

Other Real Estate Owned

Other real estate acquired through or instead of loan foreclosure is initially recorded at fair value when acquired, establishing a new cost basis. Costs after acquisition are expensed. If the fair value of the property declines, a valuation allowance is recorded through expense.

Mortgage Servicing Rights

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Mortgage servicing rights are recorded at fair value. Any changes in fair value are included in earnings in the period in which the changes occur.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan, and are recorded as income when earned.

Long-Lived Assets

Intangible assets, premises and equipment and other long-lived assets are tested for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Term Federal Funds

The Corporation buys term federal funds as an alternative investment for customer banks. Term federal funds are reflected as a liability on the consolidated balance sheet. At December 31, 2008 and 2007, term federal funds outstanding were $5,800 and $26,100, respectively, and mature within 120 days.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities (excluding deferred tax assets and liabilities related to components of other comprehensive income). Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and the tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent upon the generation of a sufficient level of future taxable income and recoverable taxes paid in prior years. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets will be realized.

Federal Funds Transactions as Agent

The Corporation acts as an agent for customer banks to purchase and sell federal funds. The Corporation acts as an intermediary for the receipt and disbursement of funds but is not otherwise obligated by the transactions. These transactions are not reflected in the Corporation's financial statements except for fees earned. At December 31, 2008 and 2007, the Corporation was agent for total federal funds transactions of $404,000 and $1,237,000, respectively.

Derivative Financial Instruments

The Corporation's hedging policies permit the use of various derivative financial instruments to manage interest rate risk or to hedge specified assets and liabilities. All derivatives are recorded at fair value on the Corporation's balance sheet. To qualify for hedge accounting, derivatives must be highly effective at reducing the risk associated with the exposure being hedged and must be designated as a hedge at the inception of the derivative contract. The Corporation considers a hedge to be highly effective if the change in fair value of the derivative hedging instrument is within 80% to 125% of the opposite change in the fair value of the hedged item attributable to the hedged risk. If derivative instruments are designated as hedges of fair values, both the change in the fair value of the hedge and the hedged item are included in current earnings. Fair value adjustments related to cash flow hedges are recorded in other comprehensive income and reclassified to earnings when the hedged transaction is reflected in earnings. Ineffective portions of hedges are reflected in earnings as they occur. During the life of the hedge, the Corporation formally assesses whether derivatives designated as hedging instruments continue to be highly effective in offsetting changes in the fair value or cash flows of hedged items. If it is determined that a hedge has ceased to be highly effective, the Corporation will discontinue hedge accounting prospectively. At such time, previous adjustments to the carrying value of the hedged item are reversed into current earnings and the derivative instrument is reclassified to a trading position recorded at fair value.

Fair Value Measurements

On January 1, 2008, the Corporation partially adopted the provisions of SFAS No. 157, "Fair Value Measurements", for financial assets and liabilities. In accordance with Financial Accounting Standards Board Staff Position ("FSP") No. SFAS 157-2, "Effective Date of FASB Statement No. 157", the Corporation will delay application of SFAS No. 157 for non-financial assets and non-financial liabilities until January 1, 2009. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accounting principles generally accepted in the United States of America, and expands disclosures about fair value instruments.

In general, fair values of financial instruments are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Corporation's creditworthiness, among other things, as well as unobservable parameters.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Dividend Restriction

Banking regulations require the maintenance of certain capital and net income levels that may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Bank to fall below specified minimum levels. Regulatory capital requirements are more fully disclosed in Note 20 – Regulatory Matters.

Comprehensive Income

Comprehensive income includes all changes in shareholders' equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of the Corporation's comprehensive income include the after tax effect of changes in the net unrealized gain/loss in securities available for sale and changes in the accumulated gain/loss on effective cash flow hedging instruments. Comprehensive income is reported in the accompanying consolidated statements of changes in shareholders' equity.

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. Such reclassifications had no effect on net income or shareholders' equity.

Effect of Newly Issued But Not Yet Effective Accounting Standards

The Financial Accounting Standard Board ("FASB") recently issued the following accounting standards:

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement No. 109, "Accounting for Income Taxes". FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

In December 2008, the FASB provided for a deferral of the effective date of FIN 48 for certain nonpublic enterprises to annual financial statements for fiscal years beginning after December 15, 2008. The Company has elected this deferral and accordingly will be required to adopt FIN 48 in its 2009 annual financial statements. Prior to adoption of FIN 48, the Company will continue to evaluate uncertain tax positions and related income tax contingencies under Statement No. 5, "Accounting for Contingencies". SFAS No. 5 requires the Company to accrue for losses it believes are probable and can be reasonably estimated. Management is currently assessing the impact of FIN 48 on its consolidated financial position and results of operations and has not yet determined if the adoption of FIN 48 will have a material effect on its financial statements.

SFAS No. 141, "Business Combinations (Revised 2007)." SFAS 141R replaces SFAS 141, "Business Combinations", and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 114 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities", would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, "Accounting for Contingencies". SFAS 141R is effective for business combinations occurring on or after January 1, 2009.

SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB Statement No. 51". SFAS 160 amends Accounting Research Bulletin (ARB) NO. 51, "Consolidated Financial Statements", to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be

reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 is effective for the Corporation on January 1, 2009 and is not expected to have a significant impact on the Corporation's financial statements.

SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133." SFAS 161 amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," to amend and expand the disclosure requirements of SFAS 133 to provide greater transparency about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedge items are accounted for under SFAS 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect and entity's financial position, results of operations and cash flows. To meet those objectives, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 is effective for the Corporation on January 1, 2009 and is not expected to have a significant impact on the Corporation's financial statements.

Note 2. Securities Available for Sale

Securities available for sale consisted of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2008:				
U.S. government agencies	**$ 117,500**	**$ 175**	**$ -**	**$ 117,675**
Mortgage-backed securities	**494,100**	**11,138**	**189**	**505,049**
Municipal securities	**600**	**-**	**2**	**598**
	$ 612,200	**$ 11,313**	**$ 191**	**$ 623,322**
December 31, 2007:				
U.S. government agencies	$ 85,192	$ 253	$ 192	$ 85,253
Mortgage-backed securities	142,934	419	966	142,387
Municipal securities	600	1	-	601
Other equity securities	10	10	-	20
	$ 228,736	$ 683	$ 1,158	$ 228,261

Mortgage-backed securities are backed by pools of mortgages that are insured or guaranteed by the Federal Home Loan Mortgage Corporation ("FHLMC"), the Government National Mortgage Corporation ("GNMA") or the Federal National Mortgage Corporation ("FNMA").

At December 31, 2008, there were no holdings of securities of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10% of shareholders' equity.

Unrealized losses, fair value and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2008 and 2007 are summarized as follows:

	Continuous Unrealized Losses Existing for Less than 12 Months		Continuous Unrealized Losses Existing for Greater than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2008:						
Municipal securities	**$ 598**	**$ 2**	**$ -**	**$ -**	**$ 598**	**$ 2**
Mortgage-backed securities	**24,767**	**189**	**-**	**-**	**24,767**	**189**
	$ 25,365	**$ 191**	**$ -**	**$ -**	**$ 25,365**	**$ 191**
December 31, 2007:						
U.S. government agencies	$ -	$ -	$ 39,975	$ 192	$ 39,975	$ 192
Mortgage-backed securities	2,022	16	79,381	950	81,403	966
	$ 2,022	$ 16	$ 119,356	$ 1,142	$ 121,378	$ 1,158

For those securities with unrealized losses at December 31, 2008, the losses are generally due to changes in interest rates and, as such, are considered by management to be temporary. Management has the ability and intent to hold these securities for a period of time sufficient for a recovery of cost.

Securities with estimated fair values of $389,651 and $39,099 at December 31, 2008 and 2007, respectively, were pledged to secure securities sold under agreements to repurchase or lines of credit as permitted by law.

The amortized cost and estimated fair value of securities available for sale at December 31, 2008, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or repay obligations. Mortgage-backed securities are shown separately since they are not due at a single due date.

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 117,500	$ 117,675
Due in five to fifteen years	600	598
Mortgage-backed securities	494,100	505,049
	$ 612,200	$ 623,322

Sales of securities available for sale were as follows:

	2008	2007
Proceeds from sales	**$ 106,249**	$ 30,059
Gross realized gains	**$ 409**	$ 47

Note 3. Loans and Allowance For Loan Losses

Year-end loans consisted of the following:

	2008	2007
Bank stock loans	**$ 121,902**	$ 112,799
Real estate loans	**292,339**	264,954
Credit card and personal loans	**122,284**	124,218
Commercial loans	**59,779**	68,267
Municipal loans	**242,086**	151,527
Other	**4,237**	11,990
	842,627	733,755
Allowance for loan losses	**(13,074)**	(9,685)
	$ 829,553	$ 724,070

As detailed in the table above, the Corporation has a diversified loan portfolio from customers primarily throughout the states of Texas, New Mexico, Oklahoma, Louisiana, Arizona and California. Accordingly, the ultimate collectability of a substantial portion of the Corporation's loan portfolio is particularly susceptible to changes in market conditions in these states.

The Corporation's officers, directors and their associates, including companies and firms of which they are officers or in which they and/or their families have an ownership interest, are customers of the Corporation. Loans to officers, directors and their associates totaled $3,947 and $2,364 at December 31, 2008 and 2007, respectively. During 2008, $2,052 of new loans were originated and repayments totaled $469. These loans were made on substantially the same terms including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than normal risk of collectability.

Activity in allowance for loan losses was as follows:

	2008	2007
Balance at beginning of year	**$ 9,685**	$ 8,623
Provision for losses charged to operations	**9,951**	2,754
Provision from acquired loan portfolios	**69**	741
Charge-offs	**(6,960)**	(2,730)
Recoveries	**329**	297
Balance at end of year	**$ 13,074**	$ 9,685

Impaired loans were as follows:

	2008	2007
Year-end impaired loans with no valuation allowance	$ 6,582	$ -
Year-end impaired loans with a valuation allowance	$ 872	$ 551
Valuation allowance related to impaired loans	$ 38	$ 60
Average investment in impaired loans during the year	$ 4,002	$ 1,017

No interest income was recognized on impaired loans in 2008 or 2007.

Loans on which the accrual of interest has been discontinued totaled $7,454 and $551 at December 31, 2008 and 2007, respectively. Loans, contractually delinquent over ninety days, which continued to accrue interest totaled $1,010 and $557 at December 31, 2008 and 2007, respectively.

Note 4. Premises and Equipment

Year-end premises and equipment was as follows:

	2008	2007
Land	$ 582	$ 582
Building	5,638	5,142
Equipment	10,118	9,463
Leasehold and tenant improvements	166	166
	16,504	15,353
Less accumulated depreciation and amortization	(11,365)	(10,489)
	$ 5,139	$ 4,864

Note 5. Other Real Estate Owned

Year-end other real estate owned was as follows:

	2008	2007
Residential property	$ -	$ 96
Commercial property	30	3,364
	$ 30	$ 3,460

Recovery of the carrying amount of other real estate owned is particularly susceptible to changes in market conditions in Texas.

Note 6. Mortgage Servicing Rights

Transactions affecting mortgage servicing rights were as follows:

	2008	2007
Balance at beginning of year	**$ 30,756**	$ 32,109
Purchased mortgage servicing rights	**9,222**	8,398
Originated mortgage serving rights	**281**	395
Decrease in fair value of mortgage serving rights	**(19,720)**	(10,146)
Balance at end of year	**$ 20,539**	$ 30,756

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgages serviced for others was $2,647,831 and $2,455,538 at December 31, 2008 and 2007, respectively. At such dates, the Corporation held borrowers' escrow balances related to these loans totaling $11,806 and $13,093, respectively.

The Corporation has purchased various 10-year treasury puts, calls and futures contracts with a net fair value of $3,681 and $747 at December 31, 2008 and 2007, respectively, and are included in other assets. The contracts provide an economic hedge against changes in fair value for the Corporation's mortgage servicing rights portfolio.

Note 7. Accumulated Other Comprehensive Income (Loss)

	Change in Fair Value of Fed Funds Swap	Change in Fair Value of Securities Available for Sale	Total Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2006	$ (313)	$ (3,452)	$ (3,765)
Change in fair value of securities available for sale	-	3,138	3,138
Change in fair value of Fed Funds Swap	(2,808)	-	(2,808)
Balance at December 31, 2007	(3,121)	(314)	(3,435)
Change in fair value of securities available for sale	-	7,654	7,654
Change in fair value of Fed Funds Swap	(11,924)	-	(11,924)
Balance at December 31, 2008	**$ (15,045)**	**$ 7,340**	**$ (7,705)**

Note 8. Fed Funds Swap

The Corporation maintains an interest-rate risk-management strategy that uses derivative instruments to minimize significant, unanticipated earnings fluctuations caused by interest rate volatility. The Corporation's specific goal is to lower (where possible) the exposure to the volatility within its variable-rate fed funds.

In 2007, the Corporation exited two interest swap contracts with notional amounts of $50,000 and $25,000 by novation. A gain of $186 and loss of $19 on the transactions are recognized in net income over the remaining contract terms of 20 months and 23 months, respectively. In 2008 and 2007, the amount of net gain recorded in other income was $102 and $51, respectively.

In 2008, the Corporation entered into four swap contracts related to certain forecasted variable-rate fed funds. The swap contracts at December 31, 2008 are summarized as follows (in thousands):

	Effective Date	Termination Date	Fixed Rate	Variable Rate	Notional Amount	Fair Value
Agreement 1	May 24, 2006	May 24, 2010	5.175 %	Fed Funds Daily Rate	$ 25,000	$ (1,646)
Agreement 2	March 16, 2006	March 16, 2010	4.978 %	Fed Funds Daily Rate	25,000	(1,434)
Agreement 3	February 16, 2006	February 16, 2010	4.905 %	Fed Funds Daily Rate	25,000	(1,334)
Agreement 4	February 16, 2007	February 16, 2011	4.940 %	Fed Funds Daily Rate	50,000	(4,477)
Agreement 5	September 8, 2008	September 8, 2014	3.445 %	Fed Funds Daily Rate	50,000	(4,681)
Agreement 6	September 8, 2008	September 8, 2014	3.445 %	Fed Funds Daily Rate	50,000	(4,654)
Agreement 7	November 28, 2008	May 28, 2016	2.685 %	Fed Funds Daily Rate	50,000	(2,386)
Agreement 8	November 28, 2008	November 28, 2015	2.620 %	Fed Funds Daily Rate	50,000	(2,184)
						$ (22,796)

Note 9. Deposits

Year-end deposits consisted of the following:

	2008		2007	
	Amount	**Percent**	Amount	Percent
Noninterest-bearing demand	**$ 236,895**	**92.2 %**	$ 172,756	42.8 %
NOW and money market accounts	**2,600**	**1.0 %**	25,302	6.3 %
Certificates of deposit:				
Less than $100,000	**215**	**0.1 %**	163	0.0 %
$100,000 and greater	**17,235**	**6.7 %**	205,280	50.9 %
	$ 256,945	**100.0 %**	$ 403,501	100.0 %

At December 31, 2008, all time deposits have scheduled maturities during the year ending December 31, 2009.

Note 10. Other Borrowings

Other borrowings consisted of the following:

	2008	2007
Federal Home Loan Bank advance originated January 14, 2004		
Interest rate: 3.04% Maturity date: January 14, 2008	**$ -**	$ 50,000
Federal Home Loan Bank advance originated May 13, 2008		
Interest rate: 4.06% Maturity date: May 13, 2013	**100,000**	-
Federal Home Loan Bank advance originated May 14, 2008		
Interest rate: 3.88% Maturity date: May 14, 2012	**100,000**	-
	$ 200,000	$ 50,000

The borrowings are secured by a blanket lien on real estate mortgage loans and marketable securities.

Note 11. Intangible Assets

	2008	2007
Purchased credit card relationships	**$ 6,241**	$ 6,241
Less accumulated amortization	**(3,943)**	(2,695)
	$ 2,298	$ 3,546

Purchased credit card relationships are amortized on a straight-line basis over their estimated lives, which is 5 years. Amortization expense of $1,248 and $1,248 was recorded in 2008 and 2007, respectively. The estimated aggregate future amortization expense for purchased credit card relationships remaining as of December 31, 2008 is as follows:

2009	1,248
2010	700
2011	350
	$ 2,298

Note 12. Junior Subordinated Debentures

On January 25, 2006, IBFC issued $30,928 of Floating Rate Junior Subordinated Debentures to a newly formed wholly owned subsidiary, IBFC Statutory Trust II (Trust II). Trust II then sold Capital Securities of $30,000. IBFC also made an equity contribution of $928 to form Trust II. Interest on the debentures is payable quarterly at LIBOR plus 1.40% (3.48 % at December 31, 2008) and the debentures mature on March 15, 2036.

IBFC's obligations under the Capital Securities and Junior Subordinated Debentures are unsecured and rank junior in priority to any existing and future indebtedness of IBFC. IBFC may, at any time, dissolve Trust II and distribute the Junior Subordinated Debentures to holders of the Capital Securities in exchange for the Capital Securities.

The Corporation accounts for the Trust in accordance with Financial Accounting Standards Board Interpretation No. 46(R), "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51" ("FIN 46(R)"). FIN 46(R) establishes accounting guidance for consolidation of variable interest entities ("VIEs") that function to support the activities of the primary beneficiary. The primary beneficiary of a VIE is the entity that absorbs a majority of the VIE's expected losses, receives a majority of the VIE's expected residual returns, or both, as a result of ownership, controlling interest, contractual relationship, or other business relationship with the VIE. Prior to the implementation of FIN 46(R), VIEs were generally consolidated by an enterprise when the enterprise had a controlling financial interest through ownership of a majority of voting interest in the entity. FIN 46(R) requires the Corporation to deconsolidate its investment in trust subsidiaries because the Corporation is not the primary beneficiary.

Note 13. Federal Income Taxes

Actual income tax expense differed from the amounts computed by applying the U.S. federal income tax rate of 35% to pretax accounting income as follows:

	2008	2007
Income tax expense computed at statutory rate	$ 6,687	$ 4,667
Increase in cash value of life insurance	(305)	(285)
Tax-exempt interest	(2,822)	(2,124)
Other	511	568
Actual income tax expense	$ 4,071	$ 2,826

Year-end deferred taxes were as follows:

	2008	2007
Deferred tax assets:		
Loans	$ 4,171	$ 3,039
Accrued expense and other liabilities	2,960	2,546
Securities available for sale	-	162
Other real estate owned	-	108
Federal fund swap	7,750	1,608
Other	306	114
Total deferred tax assets	15,187	7,577
Deferred tax liabilities:		
Securities available for sale	3,781	-
Premises and equipment	127	127
Mortgage servicing rights	4,624	7,560
FHLB stock	61	177
Total deferred tax liabilities	8,593	7,864
Net deferred tax asset (liability)	$ 6,594	$ (287)

Note 14. Employee Benefits

The Corporation maintains a savings plan for its employees. Employees are eligible to participate immediately upon hire subject to next enrollment date. Maximum employer and employee contributions to the plan are limited to $45 or 100% of an employee's gross earnings, whichever is less. The savings plan vests immediately. The Corporation may make contributions in an amount necessary to match up to a maximum of 5% of the employee's annual compensation. The Corporation's contributions were $959 and $879 in 2008 and 2007, respectively.

The Corporation has nonqualified deferred compensation plans which provide death and retirement benefits to certain officers. Benefits under the plans are payable over a 15 year period following death or retirement. Deferred compensation expense of $855 and $672 was recorded in 2008 and 2007, respectively. Deferred compensation payable totaled $5,403 and $4,952 at December 31, 2008 and 2007, respectively. The Corporation has purchased life insurance policies to fund future plan obligations. These policies had an aggregate cash surrender value of $23,335 and $22,462 at December 31, 2008 and 2007, respectively.

During 2002, the Corporation adopted a Phantom Stock Ownership and Long-Term Incentive Plan under which eligible employees may be granted phantom shares from an initial pool of 108,000 shares and such shares generally vest over five years. Holders of the phantom shares have no rights as a shareholder of the Corporation, but may redeem vested phantom shares held for cash in an amount equal to the increase in the book value of the Corporation's common stock subsequent to their grant date.

Information regarding phantom shares is as follows:

	2008	2007
Phantom shares outstanding at beginning of year	**43,485**	68,015
Redeemed	**(8,723)**	(24,530)
Phantom shares outstanding at end of year	**34,762**	43,485
Available for grant at end of year	**27,039**	27,039
Exercisable at end of year	**32,783**	37,587

In 2006, the Corporation adopted a Stock Appreciation Right Plan (SAR) under which eligible employees are awarded the right to receive a lump sum cash payment in an amount equal to the increase in the fair market value of the Corporation's stock on an established date, after the vesting period of generally five years, over the grant date price of the SAR.

In 2008 and 2007, respectively, 13,150 and 10,150 awards were granted.

Compensation expense related to phantom shares and stock appreciation rights is accrued over the vesting period of the award; however, the ultimate measurement of the aggregate compensation is based on the value of the award on the date of exercise. Accrued compensation payable under the Plans totaled $2,594 and $1,848 at December 31, 2008 and 2007, respectively. Compensation expense recognized under the Plans totaled $1,350 in 2008 and $789 in 2007. At December 31, 2008, the aggregate value of unvested shares was approximately $83 and will be recognized as the shares vest over the next year.

Note 15. Noninterest Income

Noninterest income consisted of the following for the years ended December 31, 2008 and 2007:

	2008	2007
Credit card fees	**$ 65,581**	$ 60,236
Item processing fees	**1,600**	2,391
Mortgage loan servicing fees	**6,812**	4,846
Customer security transaction fees	**6,460**	2,591
Audit and loan review fees	**1,561**	1,396
Gain on sales of loans	**4,078**	2,936
Gain on sale of securities, net	**409**	47
Federal fund agency fees	**890**	1,536
Gain on sale of other investment	**3,695**	2,061
Net gain on derivative transactions	**19,142**	6,668
Other	**9,364**	8,757
	$ 119,592	$ 93,465

Note 16. Commitments and Contingencies

Financial Instruments With Off-Balance Sheet Risk

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, credit card line commitments and standby letters of credit and involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit, credit card line commitments and standby letters of credit is represented by the contractual amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. At December 31, 2008 and 2007, the amounts of these financial instruments were as follows:

	2008	2007
Commitments to extend credit	$ 193,012	$ 219,058
Standby letters of credit	5,276	5,345
Credit card lines	714,000	693,995
	$ 912,288	$ 918,398

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Such commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, single and multi-family residences, property and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. The Corporation's policies generally require that letter of credit arrangements contain security and debt covenants similar to those contained in loan arrangements. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, single and multi-family residences, property and equipment and income-producing commercial properties. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Corporation would be required to fund the commitment. The maximum potential amount of future payments the Corporation could be required to make is represented by the contractual amount shown in the table above. If the commitment is funded, the Corporation would be entitled to seek recovery from the customer. As of December 31, 2008 and 2007, no amounts have been recorded as liabilities for the Corporation's potential obligations under these guarantees.

Credit card commitments are unsecured.

The Corporation has a revolving line of credit payable with a third party. During 2008 and 2007, the note had a maximum advanceable amount of $15,000. The line of credit accrues interest at the Wall Street Journal prime interest rate, contains certain financial covenants and is secured by the stock of the Bank. There was no balance outstanding at any time during 2008 or 2007. On January 1, 2009, the Corporation cancelled the $15,000 line of credit and opened a $40,000 line of credit with the same third party. The new line of credit has the same terms as the cancelled line of credit.

Lease Commitments

The Corporation leases certain office facilities and office equipment under operating leases that expire at various dates through 2013. The Corporation has renewal options for most of its operating leases. Rent expense for all operating leases totaled $1,039 in 2008 and $953 in 2007. Total rents paid under escalating lease agreements are expensed over the life of the lease on a straight-line basis. The rental payments on operating leases are based on a minimum rental plus a percentage of operating costs, some of which are restricted as to the maximum annual increase.

Future minimum lease payments under all noncancelable operating leases as of December 31, 2008 are as follows:

2009	$	969
2010		499
2011		424
2012		412
2013		307
	$	2,611

Contingencies

Various other contingent liabilities are not reflected in the financial statements, including claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on the Corporation's financial condition, results of operations or cash flows.

Note 17. Fair Value of Financial Instruments - SFAS 107

The estimated fair value approximates carrying value for financial instruments except those described below:

Securities Available for Sale and Derivatives

Fair values for securities and derivatives are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar instruments. The fair values of Federal Reserve Bank ("FRB") and Federal Home Loan Bank – Dallas ("FHLB") stocks approximate their carrying values based on their respective redemption provisions.

Loans Held for Sale

Fair values are based on quoted market prices of similar loans sold on the secondary market.

Loans

The fair value of fixed-rate loans and variable-rate loans which reprice on an infrequent basis is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality.

Deposits

The fair value of fixed-rate deposit liabilities with defined maturities is estimated by discounting future cash flows using the interest rates currently offered for deposits of similar remaining maturities.

Other Borrowings

The fair value of fixed rate borrowings is estimated based on the present value of expected cash flows using current interest rates for similar financial instruments.

Off-Balance Sheet Instruments

The fair values of these items are not material and are therefore not included on the following schedule.

The estimated fair values of the Corporation's financial instruments as of December 31, 2008 and 2007 were as follows:

	2008		2007	
	Carrying Amount	**Estimated Fair Value**	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash equivalents	**$ 430,616**	**$ 430,616**	$ 744,428	$ 744,428
Interest-bearing time deposits	**-**	**-**	100	98
FRB and FHLB stock	**11,402**	**11,402**	5,091	5,091
Securities	**623,322**	**623,322**	228,261	228,261
Loans held for sale	**30,854**	**30,854**	54,042	54,042
Loans, net	**829,553**	**834,014**	724,070	741,582
Mortgage servicing rights	**20,539**	**20,539**	30,756	30,756
Derivatives	**3,681**	**3,681**	747	747
Accrued interest receivable	**8,399**	**8,399**	7,680	7,680
Due from broker	**16,721**	**16,721**	9,789	9,789
Financial liabilities:				
Deposits	**256,945**	**256,953**	403,501	403,675
Federal funds purchased and securities sold under agreements to repurchase	**1,384,961**	**1,384,961**	1,224,708	1,244,656
Other borrowings	**200,000**	**206,636**	50,000	50,000
Junior subordinated debentures	**30,928**	**30,928**	30,928	30,928
Derivatives	**22,796**	**22,796**	4,729	4,729
Accrued interest payable	**774**	**774**	968	968

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Corporation's entire holdings of a particular financial instrument. These estimates are subjective in nature and require considerable judgment to interpret market data. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Corporation could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of the respective balance sheet date. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein.

Note 18. Fair Value of Financial Instruments - SFAS 157

Effective January 1, 2008, the Corporation adopted the provisions of SFAS No. 157, "Fair Value Measurements," for financial assets and financial liabilities. In accordance with Financial Accounting Standards Board Staff Position (FSP) No. SFAS 157-2, "Effective Date of FASB Statement No. 157," the Corporation will delay application of SFAS 157 for non-financial assets and non-financial liabilities, until January 1, 2009. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The application of SFAS 157 in situations where the market for a financial asset is not active was clarified by the issuance of FSP No. SFAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active," in October 2008. FSP No. SFAS 157-3 became effective immediately and did not significantly impact the methods by which the Corporation determines the fair value of its financial assets.

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

SFAS 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to

replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS 157 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Corporation's financial assets and financial liabilities carried at fair value effective January 1, 2008.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Corporation's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts have not been comprehensively revolved since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein.

Securities Available for Sale - Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Corporation obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury and other yield curves, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things.

Derivatives - Derivatives are reported at fair value utilizing Level 1 and Level 2 inputs. The Corporation uses dealer quotations obtained from third party firms for derivatives used for hedging mortgage servicing rights. Third party firms make use of exchange settlement prices (Level 1) which are published daily to value these derivatives. The Corporation uses an independent valuation firm to estimate fair value of interest rate swaps through the use of valuation models with observable market data inputs (Level 2).

Mortgage Servicing Rights - Mortgage servicing rights are reported at fair value utilizing Level 3 inputs. The Corporation uses an independent valuation firm to estimate fair value of mortgage servicing rights through the use of prevailing market participant assumptions and market participant valuation processes. This valuation and its techniques are periodically tested and validated against other third-party firm valuations.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2008, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Securities available for sale	$ -	$ 623,322	$ -	$ 623,322
Mortgage-servicing rights	-	-	20,539	20,539
Derivative assets	3,681	-	-	3,681
Derivative liabilities	-	22,796	-	22,796

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and liabilities measured at fair value on a non-recurring basis are as follows:

Impaired Loans - Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. For the year ended December 31, 2008, impaired loans with a carrying value of $6,582 had no specific valuation allowance allocations and impaired loans with a carrying value of $872 had a specific valuation allowance of $38. The total reported fair value of $872 was based on collateral valuations utilizing Level 2 valuation inputs.

Loans Held For Sale – Loans held for sale are reported at fair value if, on an aggregate basis, the fair value of the loans is less than cost. In determining whether the fair value of loans held for sale is less than cost when quoted market prices are not available, the Corporation may consider outstanding investor commitments or discounted cash flow analyses with market assumptions. Such loans are generally classified within Level 2 of the fair value hierarchy.

Note 19. Shareholders' Equity

The Corporation has 1,000,000 authorized shares of $1 par value convertible preferred stock (Series B, C and D) with a liquidation value of $20 per share. No shares were outstanding at December 31, 2008 or 2007.

The Corporation maintains a Dividend Reinvestment and Share Purchase Plan whereby shareholders may elect to: (1) reinvest common stock dividends in the common stock of the Corporation, and (2) make optional cash payments to purchase additional common stock of the Corporation. The purchase price of common shares issued under the Plan is the book value of the stock (excluding other comprehensive income) as of the quarter ended immediately preceding the reinvestment date. During 2008 and 2007, 5,781 and 5,261 shares of common stock were issued under the Plan with an average issue price of $93.66 and $83.76 per share, respectively.

Note 20. Regulatory Matters

Banks and bank holding companies are subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, specific capital guidelines that involve quantitative measures of the Corporation's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices must be met. The Corporation's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulations to ensure capital adequacy require the maintaining of minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined).

As of December 31, 2008 and 2007, the Bank met the level of capital necessary to be categorized as "well capitalized" under prompt corrective action regulations. To be categorized as "well capitalized," the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. As of December 31, 2008 and 2007, the Corporation met all capital requirements under the regulatory framework specified by the Federal Reserve Board. Management is not aware of any conditions subsequent to December 31, 2008 that would change the Corporation's or the Bank's capital category.

The Corporation's and the Bank's actual capital amounts and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2008:						
Total capital to risk weighted assets:						
Consolidated	**$ 155,441**	**11.7%**	**$ 105,942**	**8.0%**	**N/A**	**N/A**
Bank only	**152,823**	**11.6%**	**105,691**	**8.0%**	**$ 132,113**	**10.0%**
Tier I capital to risk weighted assets:						
Consolidated	**142,367**	**10.8%**	**52,976**	**4.0%**	**N/A**	**N/A**
Bank only	**139,749**	**10.6%**	**52,845**	**4.0%**	**79,268**	**6.0%**
Tier I capital to average assets:						
Consolidated	**142,367**	**6.3%**	**89,949**	**4.0%**	**N/A**	**N/A**
Bank only	**139,749**	**6.2%**	**89,851**	**4.0%**	**112,314**	**5.0%**
December 31, 2007:						
Total capital to risk weighted assets:						
Consolidated	$ 133,696	12.0 %	$ 89,047	8.0 %	N/A	N/A
Bank only	130,147	11.7 %	88,808	8.0 %	$ 111,009	10.0 %
Tier I capital to risk weighted assets:						
Consolidated	124,006	11.1 %	44,523	4.0 %	N/A	N/A
Bank only	120,457	10.9 %	44,404	4.0 %	66,606	6.0 %
Tier I capital to average assets:						
Consolidated	126,006	6.8 %	73,281	4.0 %	N/A	N/A
Bank only	120,457	6.6 %	73,242	4.0 %	91,553	5.0 %

Note 21. Parent Company Only Financial Statements

Balance Sheets

	December 31, 2008	2007
ASSETS		
Cash due from subsidiary bank	$ 4,732	$ 4,433
Investment in subsidiaries	137,896	125,277
Other assets	3,258	3,623
Total assets	$ 145,886	$ 133,333
LIABILITIES AND SHAREHOLDERS' EQUITY		
Dividends payable	$ 1,790	$ 1,637
Junior subordinated debentures	30,928	30,928
Other liabilities	2,654	1,941
Total liabilities	35,372	34,506
Commitments and contingencies	-	-
Shareholders' equity:		
Common stock, par value $10 per share, 5,000,000 shares authorized; 1,118,250 and 1,091,796 shares issued and outstanding in 2008 and 2007	11,182	10,918
Capital surplus	25,838	23,391
Retained earnings	81,199	67,953
Accumulated other comprehensive loss	(7,705)	(3,435)
Total shareholders' equity	110,514	98,827
Total liabilities and shareholders' equity	$ 145,886	$ 133,333

Statements of Income

	Year Ended December 31, 2008	2007
Dividend income	$ -	$ 2,500
Interest income	45	65
Interest expense	(1,477)	(2,166)
	(1,432)	399
Other Income	21	-
Other expenses	(1,400)	(854)
Loss before income taxes and equity in undistributed income of subsidiaries	(2,811)	(455)
Federal:		
Federal income taxes - current benefit	958	1,005
Income (loss) before equity in undistributed income of subsidiaries	(1,853)	550
Equity in undistributed income of subsidiaries	16,889	9,958
Net income	$ 15,036	$ 10,508

Statements of Cash Flows

	Year Ended December 31, 2008	2007
Cash flows from operating activities:		
Net income	$ 15,036	$ 10,508
Adjustments to reconcile net income to net cash used in operating activities:		
Equity in undistributed income of subsidiaries	(16,889)	(9,958)
Deferred compensation expense	1,350	789
Changes in operating assets and liabilities:		
Other assets	365	(463)
Other liabilities	(637)	(1,371)
Net cash used in operating activities	(775)	(495)
Cash flows from financing activities:		
Purchase and retirement of common stock	(576)	(1,092)
Net proceeds from issuance of common stock	3,287	3,538
Cash dividends paid on common stock	(1,637)	(1,521)
Net cash provided by financing activities	1,074	925
Net increase in cash equivalents	299	430
Cash equivalents at beginning of year	4,433	4,003
Cash equivalents at end of year	$ 4,732	$ 4,433
Supplemental cash flow information:		
Cash paid during the year for interest	$ 1,509	$ 2,182
Cash paid during the year for taxes	4,157	2,207