

GREEN BANKSHARES, INC.

Form 10-K

April 10, 2012

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2011**

**or**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from            to**

**Commission file number 0-14289**

**GREEN BANKSHARES, INC.**

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(Exact name of registrant as specified in its charter)

**Tennessee** **62-1222567**  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)  
**100 North Main Street, Greeneville, Tennessee** **37743-4992**  
(Address of principle executive offices) (Zip Code)  
**Registrant's telephone number, including area code: (423) 639-5111**

**Securities registered pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of each Exchange on which Registered
Common Stock - \$.01 par value	Nasdaq Global Select Market

**Securities registered pursuant to Section 12(g) of the Act:**

None

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

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

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

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES  NO

The aggregate market value of the voting stock held by non-affiliates of the registrant on June 30, 2011, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$32 million. The market value calculation was determined using the closing sale price of the registrant's common stock on June 30, 2011, as reported on the Nasdaq Global Select Market. For purposes of this calculation, the term affiliate refers to all directors, executive officers and 10% shareholders of the registrant. As of the close of business on April 5, 2012, 133,160,384 shares of the registrant's common stock were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

The following lists the documents incorporated by reference and the Part of the Form 10-K into which the document is incorporated:

1. Portions of Proxy Statement for 2012 Annual Meeting of Shareholders. (Part III)

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**PART I**

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This document contains forward-looking statements. Any statements about our expectations, beliefs, plans, predictions, forecasts, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through the use of words or phrases such as anticipate, believes, can, could, may, predicts, potential, should, will, estimate, continuing, ongoing, expects, intends and similar words or phrases. Accordingly, these statements are only predictions and involve estimates, known and unknown risks, assumptions and uncertainties that could cause actual results to differ materially from those expressed in them. Our actual results could differ materially from those anticipated in such forward-looking statements as a result of several factors more fully described under the caption Risk Factors and elsewhere in this document, including the appendices hereto.

Any or all of our forward-looking statements in this document may turn out to be inaccurate. The inclusion of this forward-looking information should not be regarded as a representation by the Company or any other person that the future plans, estimates or expectations contemplated by the Company will be achieved. The Company based these forward-looking statements largely on current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements including, but not limited to, statements regarding:

changes in general economic and financial market conditions;

changes in the regulatory environment;

economic conditions generally and in the financial services industry;

changes in the economy affecting real estate values;

our ability to achieve loan and deposit growth;

the completion of the proposed merger with our controlling shareholder, Capital Bank Financial Corp.;

the completion of our future acquisitions or business combinations and our ability to integrate the acquired business into our business model;

projected population and income growth in our targeted market areas; and

volatility and direction of market interest rates and a weakening of the economy which could materially impact credit quality trends and the ability to generate loans.

All forward-looking statements are necessarily only estimates of future results, and actual results may differ materially from expectations. You are, therefore, cautioned not to place undue reliance on such statements which should be read in conjunction with the other cautionary statements that are included elsewhere in this document. In particular, you should consider the numerous risks described in the Risk Factors section of this document. Further, any forward-looking statement speaks only as of the date on which it is made and we undertake no obligation to update or revise any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence

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of unanticipated events. You should, however, review the risk factors we describe in the reports we will file from time to time with the Securities and Exchange Commission ( SEC ) after the date of this report.

### **ITEM 1. BUSINESS.**

As used in this document, the terms we, us, our, Green Bankshares, and Company mean Green Bankshares, Inc. and its subsidiaries (unless context indicates another meaning).

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### **The Company**

Green Bankshares is a bank holding company incorporated in 1985 and headquartered in Greeneville, Tennessee. Prior to September 7, 2011, Green Bankshares conducted its business primarily through its wholly-owned subsidiary, GreenBank (together with its predecessor entities prior to, and successor entities following the Bank Merger (as defined below), the Bank ). As described in additional detail in Note 3, on September 7, 2011 (the Merger Date ), the Bank merged (the Bank Merger ) with and into Capital Bank, National Association ( Capital Bank, NA ), a subsidiary of our majority shareholder, Capital Bank Financial Corp. ( CBF ), in an all-stock transaction, with Capital Bank, NA as the surviving entity. Green Bankshares' approximately 34% ownership interest in Capital Bank, NA is recorded as an equity-method investment in that entity. In addition, five of the seven directors of Green Bankshares, and the Company's Chief Executive Officer, Chief Financial Officer and Chief Risk Officer are affiliated with CBF. Through our branches, we offer a wide range of commercial and consumer loans and deposits, as well as ancillary financial services.

Unless otherwise specified, this report describes Green Bankshares, Inc. and its subsidiaries including GreenBank through the Merger Date, and subsequent to that date, includes only Green Bankshares, Inc. and its equity method investment in Capital Bank, NA.

### **CBF Investment**

On September 7, 2011, (the Transaction Date ) the Company completed the issuance and sale to CBF of 119.9 million shares of Common Stock to CBF for aggregate consideration of \$217,019,000 less \$750 thousand of CBF's expenses which were reimbursed by the Company.

The consideration was comprised of approximately \$147.6 million in cash and approximately \$68.7 million in the form of a contribution to the Company of all 72,278 outstanding shares of Series A Preferred Stock previously issued to the United States Department of the Treasury under the TARP Capital Purchase Program and the related warrant to purchase shares of the Company's Common Stock, which CBF purchased directly from the Treasury. The Series A Preferred Stock and the related warrant were retired on September 7, 2011 and are no longer outstanding. In connection with the CBF Investment, each Company shareholder as of September 6, 2011 received on contingent value right per share ( CVR ) that entitles the holder to receive up to \$0.75 in cash per CVR at the end of a five-year period based on the credit performance of GreenBank's then existing loan portfolio as of May 5, 2011.

As a result of the CBF Investment, CBF owns approximately 90% of the issued and outstanding voting power of the Company. Upon the completion of the Investment, R. Eugene Taylor (Chairman), Christopher G. Marshall, Peter N. Foss, William A. Hodges and R. Bruce Singletary were named to board of directors of the Company (the Company Board ). Ms. Martha M. Bachman and Dr. Samuel E. Lynch, existing members of the Company Board, remained as such following the closing of the Investment. All other members of the Company Board resigned effective September 7, 2011.

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Because of the controlling proportion of voting securities in the Company acquired by CBF, the CBF Investment is considered an acquisition for accounting purposes and requires the application and push down of the acquisition method of accounting. The accounting guidance for acquisition accounting requires that the assets acquired and liabilities assumed be recorded at their respective fair values as of the acquisition date. Any purchase price in excess of the net assets acquired is recorded as goodwill.

The most significant fair value adjustments resulting from the application of the acquisition method of accounting were made to loans. Accounting guidance requires that all loans held by the Company on the Transaction Date be recorded at their fair value. The fair value of these acquired loans takes into account both the differences in loan interest rates and market rates and any deterioration in their credit quality. Because concerns about the probability of receiving the full amount of the contractual payments from the borrowers was considered in estimating the fair value of the loans, stating the loans at their fair value results in no allowance for loan loss being provided for these loans as of the Transaction Date. As of September 7, 2011, certain loans had evidence of credit deterioration since origination, and it was probable that not all contractually required principal and interest payments would be collected. Such loans identified at the time of the acquisition were accounted for using the measurement provision for purchased credit-impaired (PCI) loans, according to the FASB Accounting Standards Codification (ASC) 310-30. The special accounting for PCI loans not only requires that they are recorded at fair value at the date of acquisition and that any related allowance for loan and lease losses is not permitted to be carried forward past the Transaction Date, but it also governs how interest income will be recognized on these loans and how any further deterioration in credit quality after the Transaction Date will be recognized and reported.

As a result of the adjustments required by the acquisition method of accounting, the Company's balance sheet and results of operations from periods prior to the Transaction Date are labeled as Predecessor Company amounts and are not comparable to balances and results of operations from periods subsequent to the Transaction Date, which are labeled as Successor Company. The lack of comparability arises from the assets and liabilities having new accounting bases as a result of recording them at their fair values as of the Transaction Date rather than at their historical cost basis. As a result of the change in accounting bases, items of income and expense such as the rate of interest income and expense as well as depreciation and rental expense will change. In general, these changes in income and expense relate to the amortization of premiums or accretion of discounts to arrive at contractual amounts due. To call attention to this lack of comparability, the Company has placed a black line between the Successor Company and Predecessor Company columns in the Consolidated Financial Statements and in the tables in the notes to the statements and in Management's Discussion and Analysis of Financial Condition and Results of Operations.

**GreenBank Merger with Capital Bank, NA**

On September 7, 2011, GreenBank, which was formerly a wholly-owned subsidiary of the Company, merged with and into Capital Bank, NA, a national banking association and subsidiary of TIB Financial Corp. (the TIB Financial), a corporation organized under the laws of the State of Florida, Capital Bank Corporation, a corporation organized under the laws of the state of North Carolina (Capital Bank Corp.) and CBF, with Capital Bank, NA as the surviving entity. CBF is the owner of approximately 90% of the Company's common stock, approximately 83% of Capital Bank Corp.'s common stock and approximately 94% of TIB Financial's common stock. TIB Bank, the former wholly-owned banking subsidiary of TIB Financial, merged with and into Capital Bank, NA (formerly known as NAFH National Bank) on April 29, 2011. Capital Bank, the former wholly-owned banking subsidiary of Capital Bank Corp. merged with and into Capital Bank, NA (formerly known as NAFH National Bank) on June 30, 2011.

At December 31, 2011, the Company's net investment of \$315.3 million in Capital Bank, NA, was recorded in the Consolidated Balance Sheet as Equity method investment in Capital Bank, NA which represented the Company's pro rata ownership of Capital Bank, NA's total shareholders equity. In periods subsequent to the Merger Date, the Company has and will adjust this equity investment balance based on its equity in Capital Bank, NA's net income and comprehensive income. In connection with the Bank Merger, assets and liabilities of the Bank were de-consolidated from the Company's balance sheet resulting in a significant decrease in the total assets and total liabilities of the Company in the third quarter of 2011. Accordingly, as of December 31, 2011, no investments, loans or deposits are reported on the Company's Consolidated Balance Sheet and subsequent to the Merger Date, interest expense is the result of the outstanding trust preferred securities issued by the Company.

Capital Bank, NA was formed in connection with the July 16, 2010 purchase and assumption of assets and deposits and other liabilities of three banks (collectively, the FDIC Banks) Metro Bank of Dade County (Miami, Florida), Turnberry Bank (Aventura, Florida) and First National Bank of the South (Spartanburg, South Carolina) (collectively, the Failed Banks) from the Federal Deposit Insurance Corporation (the FDIC) and is a party to loss sharing agreements with the FDIC covering the large majority of the loans it acquired from the FDIC. As of December 31, 2011, following the mergers of TIB Bank, Capital Bank and GreenBank, as discussed above, Capital Bank, NA had total assets of \$6.5 billion, total deposits of \$5.1 billion and shareholders' equity of \$939.8 million. As of December 31, 2011, following the mergers of TIB Bank, Capital Bank and GreenBank as discussed above, Capital Bank, NA operated 143 branches in Florida, North Carolina, South Carolina, Tennessee and Virginia.





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### **Potential Merger of Green Bankshares and Capital Bank Financial Corp.**

On September 8, 2011, CBF's Board of Directors approved and adopted a plan of merger which provides for the merger of Green Bankshares, Inc. with and into CBF, with CBF continuing as the surviving entity (the "Merger"). In the merger, each share of Green Bankshares, Inc. common stock issued and outstanding immediately prior to the completion of the merger, except for certain shares held by CBF or Green Bankshares, Inc., will be converted into the right to receive .0915 of a share of CBF Class A common stock. No fractional share of Class A common stock will be issued in connection with the merger, and holders of Green Bankshares, Inc. common stock will be entitled to receive cash in lieu thereof. Since CBF currently owns more than 90% of the common stock of Green Bankshares, Inc., under Delaware and Tennessee law, no vote of our stockholders is required to complete the merger. CBF will determine when and if the merger will ultimately take place.

### **Consent Order**

During the third quarter of 2011, the FDIC and the Tennessee Department of Financial Institutions ("TDFI") issued a consent order against the Bank aimed at strengthening the Bank's operations and its financial condition. The order's provisions included requirements similar to those that the Bank has already informally committed to comply with, including requirements to maintain the Bank's capital ratios above those levels required to be considered "well-capitalized" under federal banking regulations. The Consent Order terminated on September 7, 2011 when GreenBank was merged with and into Capital Bank, NA.

### **Capital Bank's Business Strategy**

Our business strategy is to build a mid-sized regional bank by operating, integrating and growing our existing operations as well as to acquire other banks, including failed, underperforming and undercapitalized banks and other complementary assets. We believe recent and continuing dislocations in the southeastern U.S. banking industry have created an opportunity for us to create a mid-sized regional bank that will be able to realize greater economies of scale compared to smaller community banks while still providing more personalized, local service than larger-sized banks.

### **Operating Strategy**

Our operating strategy emphasizes relationship banking focused on commercial and consumer lending and deposit gathering. We have organized operations under a line of business operating model, under which we have appointed experienced bankers to oversee loan and deposit production in each of our markets, while centralizing credit, finance, technology and operations functions. Our management team possesses significant executive-level leadership experience at Fortune 500 financial services companies, and we believe this experience is an important advantage in executing this regional, more focused, bank business model.

### **Organic Loan and Deposit Growth**

The primary components of our operating strategy are to originate high-quality loans and low-cost customer deposits. Our executive management team has developed a hands-on operating culture focused on performance and accountability, with frequent and detailed oversight by executive management of key performance indicators. We have implemented a sales management system for our branches that is focused on growing loans and core deposits in each of our markets. We believe that this system holds loan officers and branch managers accountable for achieving loan production goals, which are subject to the conservative credit standards and disciplined underwriting practices that we have implemented as well as compliance, profitability and other standards that we monitor. We also believe that accountability is crucial to our results. Our executive management monitors production, credit quality and profitability measures on a quarterly, monthly, weekly and, in some cases, daily basis and provides ongoing feedback to our business unit leaders. During 2011, we originated \$728.4 million of new commercial and consumer loans. During this period, the Bank we also grew its core deposits by \$265.4 million (or 29.3% annualized growth) excluding the initial increase in deposits resulting from CBF's acquisitions of Capital Bank Corp. and Green Bankshares, Inc.

The current market conditions have forced many banks to focus internally, which we believe creates an opportunity for organic growth by strongly capitalized banks such as ourselves. We seek to grow our loan portfolio by offering personalized customer service, local market knowledge and a long-term perspective. We have selectively hired experienced loan officers with local market knowledge and existing client relationships. Additionally, our executive management team takes an active role in soliciting, developing and maintaining client relationships.

**Table of Contents****Efficiency and Cost Savings**

Another key element of our strategy is to operate efficiently by carefully managing our cost structure and taking advantage of economies of scale afforded by our acquisitions to control operating costs. We have been able to reduce headcount by consolidating duplicative operations of the acquired banks and streamlining management. In addition, we expect to recognize additional cost savings now that we have fully integrated Green Bankshares, Inc., with the rest of CBF's business. We plan to further improve efficiency by boosting the productivity of our sales force through our focus on accountability and employee incentives and through selective hiring of experienced loan officers with existing books of business.

To evaluate and control operating costs, we monitor certain performance metrics including our efficiency ratio, which equals total non-interest expenses divided by net revenues (net interest income plus non-interest income). Our efficiency ratio has been and is expected to continue to be significantly impacted by certain costs that follow acquisitions of financial institutions. Capital Bank's efficiency ratio for 2011 was 69.6%, which was impacted by \$7.6 million of conversion expenses due to integration of the acquired banks. Excluding the impact of these items, Capital Bank's adjusted efficiency ratio for 2011 was 66.6%. The adjusted efficiency ratio is a non-GAAP measure which we believe provides investors with information useful in understanding our business and our operating efficiency. Comparison of our adjusted efficiency ratio with those of other companies may not be possible because other companies may calculate the adjusted efficiency ratio differently. The adjusted efficiency ratio, which equals adjusted non-interest expense (non-interest expense less conversion expense) divided by net revenues (net interest income plus non-interest income), for the twelve months ended December 31, 2011 is as follows:

Capital Bank, NA (Dollars in thousands)	Efficiency Ratio for the Twelve Months Ended December 31, 2011	
	Non-adjusted	Adjusted
Non-interest expense	\$ 163,710	\$ 163,710
Less: Conversion expense		(7,620)
Non-interest expense, adjusted	\$ 163,710	\$ 156,090
Net interest income	\$ 193,598	\$ 193,598
Non-interest income	40,660	40,660
Net Revenue	\$ 234,258	\$ 234,258
Efficiency Ratio	69.9%	66.6%

**Capital Bank's Acquisition and Integration Strategy****Acquisition and Integration Strategy**

We seek acquisition opportunities consistent with our business strategy that we believe will produce attractive returns for our stockholders. We plan to pursue acquisitions that position us in southeastern U.S. markets with attractive demographics and business growth trends, expand our branch network in existing markets, increase our earnings power or enhance our suite of products. Our future acquisitions may include distressed assets sold by the FDIC or another seller where our operations, underwriting and servicing capabilities or management experience give us an advantage in evaluating and resolving the assets.

Our acquisition process begins with detailed research of target institutions and the markets they serve. We then draw on our management team's extensive experience and network of industry contacts in the southeastern region of the United States. Our research and analytics team, led by our Chief of Investment Analytics and Research, maintains lists of priority targets for each of our markets. The team analyzes financial, accounting, tax, regulatory, demographic, transaction structures and competitive considerations for each target and prepares acquisition projections for review by our executive management team and Board of Directors.

As part of our diligence process in connection with potential acquisitions, we undertake a detailed portfolio- and loan-level analysis conducted by a team of experienced credit analysts led by our Chief Risk Officer. In addition, our executive management team engages the target management teams in active dialogue and personally conducts extensive on-site diligence at target branches.



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Our executive management team has demonstrated success not only in acquiring financial institutions and combining them onto a common platform, but also in managing the integration of those financial institutions. Our management team develops integration plans prior to the closing of a given transaction that allows us to (1) reorganize the acquired institution's management team under our line of business model immediately after closing; (2) implement our credit, risk and interest rate risk management, liquidity and compliance and governance policies and procedures; and (3) integrate our target's technology and processing systems rapidly. Using our procedures, we have already integrated credit and operational policies across each of our acquisitions. We reorganized the management of the Failed Banks within three months of closing, and we merged their core processing systems with TIB Financial's platform within six months. We also fully integrated legacy Capital Bank in July 2011 and GreenBank in February 2012.

## **Sound Risk Management**

Sound risk management is an important element of our commercial/retail bank business model and is overseen by our Chief Risk Officer, Bruce Singletary, who has over 19 years of experience managing credit risk. Our credit risk policy, which has been implemented across our organization, establishes prudent underwriting guidelines, limits portfolio concentrations by geography and loan type and incorporates an independent loan review function. Mr. Singletary has created a special assets division with 35 employees to work out or dispose of legacy problem assets using a detailed process taking into account a borrower's repayment capacity, available guarantees, collateral value, interest accrual and other factors. We believe our risk management policies establish conservative regulatory capital ratios, robust liquidity (including contingency planning), limitations on wholesale funding (including brokered CDs, holding company debt and advances from the FHLB), and restrictions on interest rate risk.

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### **Our Competitive Strengths**

***Experienced and Respected Management Team with a Successful Track Record.*** Members of our executive management team and Board of Directors have served in executive leadership roles at Fortune 500 financial services companies, including Bank of America, Fifth Third Bancorp and Morgan Stanley. The executive management team has extensive experience overseeing commercial and consumer banking, mergers and acquisitions, systems integrations, technology, operations, credit and regulatory compliance. Many members of our executive management team are from the southeastern region of the United States and have an extensive network of contacts with banking executives, existing and potential customers, and business and civic leaders throughout the region. We believe our executive management team's reputation and track record give us an advantage in negotiating acquisitions and hiring and retaining experienced bankers.

***Growth-Oriented Business Model.*** Our executive management team seeks to foster a strong sales culture with a focus on developing key client relationships, including direct participation in sales calls, and through regular reporting and accountability while emphasizing risk management. Our executive management and line of business executives monitor performance on a quarterly, monthly, weekly and in some cases daily basis, and our compensation plans reward core deposit and responsible commercial loan growth, subject to credit quality, compliance and profitability standards. We have an integrated, scalable core processing platform and centralized credit, finance and technology operations that we believe will support future growth. Our business model contributed to the Bank's \$728.4 million of commercial and consumer loan originations and \$265.4 million in total deposit growth for 2011, excluding the initial increase in deposits resulting from CBF's acquisitions of Capital Bank Corporation and Green Bankshares, Inc.

***Highly Skilled and Disciplined Acquirer.*** CBF has executed six acquisitions in just 14 months. CBF integrated its first four investments into a common core processing platform within six months, integrated the fifth in July 2011 and the sixth in February 2012. We believe our track record of completing and integrating transactions quickly has helped us negotiate transactions on more economically favorable terms. CBF has conducted due diligence on more than 82 financial institutions, many of which its diligence process indicated would not meet its strategic objectives.

***Reduced-Risk Legacy Portfolio.*** Our acquired loan portfolios have been marked-to-market with the application of the acquisition method of accounting, meaning that the carrying value of these assets at the time of their acquisitions reflected our estimate of lifetime credit losses. In addition, as of December 31, 2011, approximately 13% of our loan portfolio was covered by the loss sharing agreements we entered into with the FDIC, resulting in limited credit risk exposure for these assets.

***Excess Capital and Liquidity.*** As a result of its private placements and the disciplined deployment of capital, CBF has ample capital with which to make acquisitions. As of December 31, 2011, CBF had a 13.2% tangible common equity ratio (which is a non-GAAP measure used by certain regulators, financial analysts and others to measure core capital strength) and a 12.6% Tier 1 leverage ratio, which provides CBF with \$165.9 million in excess capital relative to the 10% Tier 1 leverage standard required under Capital Bank's operating agreement with the OCC. As of December 31, 2011, Capital Bank had a 10.4% Tier 1 leverage ratio, a 15.7% Tier 1 risk-based ratio and a 16.7% total risk-based capital ratio. As of December 31, 2011, Capital Bank had cash and securities equal to 21.6% of total assets, representing \$427.3 million of liquidity in excess of our target of 15%, which provides ample liquidity to support our existing banking franchises. Further, our investment portfolio consists primarily of U.S. agency-guaranteed mortgage-backed securities, which have limited credit or liquidity risk. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources for a discussion of the use of the tangible common equity ratio in our business and the reconciliation of tangible common equity ratio.

***Scalable Back-Office Systems.*** All of CBF's acquired institutions operate on a single information processing system. Our systems are designed to accommodate all of our projected future growth and allow us to offer our customers virtually all of the services currently offered by the nation's largest financial institutions, including state-of-the-art online banking. Enhancements made to our systems are included to improve our commercial and consumer loan origination, electronic banking and direct response marketing processes, as well as enhance cash management, streamlined reporting, reconciliation support and sales support.

### **Our Market Area**

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We view our market area as the southeastern region of the United States. Our six acquisitions have established a footprint defined by the Miami-Raleigh-Nashville triangle, which includes the Carolinas, Southwest Florida (Naples) and Southeast Florida (Miami-Dade and the Keys). These markets include a combination of large and fast-growing metropolitan areas that we believe will offer us opportunities for organic loan and deposit growth. Approximately 47% of our current branches are located in our target MSAs.

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### **Products and Services**

#### **Banking Services by Business Line**

Capital Bank has integrated each of CBF's six acquisitions under a single line of business operating model. Under this model, we have appointed experienced bankers to oversee loan and deposit growth in each of our markets, while we have centralized other functions, including credit, finance, operations, marketing, human resources and information technology.

#### **The Commercial Bank**

Our commercial bank business consists of teams of commercial loan officers operating under the leadership of commercial banking executives in Florida the Carolinas and Tennessee markets. The commercial banking executives are responsible for production goals for loans, deposits and fees. They work with senior credit officers to ensure that loan production is consistent with our loan policies and with financial officers to ensure that loan pricing is consistent with our profitability goals. We focus our commercial bank business on loan originations for established small and middle-market businesses with whom we develop personal relationships that we believe give us a competitive advantage and differentiates us from larger banking institutions. In addition, our commercial lending teams coordinate with personnel in our consumer bank business to provide personal loans and other services to the owners and managers and employees of the bank's commercial clients. At December 31, 2011, commercial loans totaled \$2.9 billion (or 67.0% of our total loan portfolio). Commercial underwriting is driven by cash flow analysis supported by collateral analysis and review. Our commercial lending teams offer a wide range of commercial loan products, including:

owner occupied commercial real estate construction and term loans;

working capital loans and lines of credit;

demand, term and time loans; and

equipment, inventory and accounts receivable financing.

During 2011, Capital Bank originated \$561.8 million of new commercial loans. Our commercial lending teams also seek to gather low-cost deposits from commercial customers in connection with extending credit. In addition to business demand, savings and money market accounts, we also provide specialized cash management services and deposit products.

#### **The Consumer Bank**

Our consumer bank business consists of Capital Bank's retail banking branches and associated businesses. Similar to our commercial bank business, we have organized the consumer bank by geographical market, with divisions consisting of our Florida, Carolina and Tennessee branches. Each division reports to a consumer banking executive responsible for achieving core deposit and consumer loan growth goals. Pricing of our deposit products is reviewed and approved by our asset-liability committee and the standards for consumer loan credit quality are documented in our loan policy and reviewed by our credit executives.

We seek to differentiate our consumer bank business from competitors through the personalized service offered by our branch managers, customer service representatives, tellers and other staff. We offer various services to meet the needs of our customers, including checking, savings and money market accounts, certificates of deposit and debit and credit cards. Our products are designed to foster relationships by rewarding our best customers for desirable activities such as debit card transactions, e-statements and direct deposit. In addition to traditional products and services, we offer competitive technology in Internet banking services, which we plan to further upgrade in order to keep pace with technological improvements. Consumer loan products we offer include:

home equity lines of credit;



residential first lien mortgages;

second lien mortgages;

new and used auto loans;

new and used boat loans;

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overdraft protection; and

unsecured personal credit lines.

Branch managers and their staff are charged with growing core deposits with a special focus on new demand deposit accounts and expected to conduct outbound telephone campaigns, generate qualified referrals, collaborate with business partners in the commercial lending teams and evaluate, and make informed decisions with respect to, existing and prospective customers. In 2011, the Bank generated organic core deposit growth of \$265.4 million (or 29.3% annualized growth) excluding the initial increase in deposits resulting from the acquisitions of Capital Bank Corporation and Green Bankshares, Inc. As of December 31, 2011, consumer loans totaled \$1.4 billion. During 2011, the Bank originated \$166.6 million of new consumer loans.

### **Ancillary Fee-Based Businesses**

#### ***Mortgage Banking***

Through our newly established mortgage banking business, we aim to originate high-quality loans for customers who are willing to establish a deposit relationship with us. The mortgage loans in our portfolio that do not meet this criteria are sold in to the secondary market to buyers, such as Fannie Mae and Freddie Mac, and provide an additional source of fee income. Our mortgage banking capabilities include conventional and nonconforming mortgage underwriting and construction and permanent financing.

#### ***Private Banking, Trust and Investment Management***

We offer private banking and wealth management services to affluent clients, business owners and retirees, building new relationships and expanding existing relationships to grow deposits, loans and fiduciary and investment management fee income. Through private banking, we offer deposit products, commercial and consumer loans, including mortgage financing, and investment accounts providing access to a wide range of mutual funds, annuities and other financial products, as well as access to our affiliate, Naples Capital Advisors, which is a registered investment advisor with approximately \$102 million in assets under management as of December 31, 2011.

### **Lending Activities**

We originate a variety of loans, including loans secured by real estate, loans for construction, loans for commercial purposes, loans to individuals for personal and household purposes, loans to municipalities and loans for new and used cars. A significant portion of our loan portfolio is related to real estate. As of December 31, 2011, loans related to real estate totaled \$3.7 billion (or 86% of our total loan portfolio). The economic trends in the regions we serve are influenced by the industries within those regions. Consistent with our emphasis on being a community-oriented financial institution, most of our lending activity is with customers located in and around counties in which we have banking offices. As of December 31, 2011, our owner occupied commercial real estate loans, non-owner occupied commercial real estate loans, residential mortgage loans and commercial and industrial loans represented 21%, 21%, 19% and 11%, respectively, of our \$4.3 billion loan portfolio.

We use a centralized risk management process to ensure uniform credit underwriting that adheres to our loan policies as approved annually by the CBF Board of Directors. Lending policies are reviewed on a regular basis to confirm that we are prudent in setting underwriting criteria. Credit risk is managed through a number of methods, including a loan approval process that establishes consistent procedures for the processing and approval of loan requests, risk grading of all commercial loans and certain consumer loans and coding of all loans by purpose, class and collateral type. We seek to focus on underwriting loans that enhance a balanced, diversified portfolio. Management analyzes our commercial real estate concentrations by market and region on a regular basis in an attempt to prevent overexposure to any one type of commercial real estate loan and incorporates third-party real estate and market analysis to monitor market conditions. As of December 31, 2011, the carrying value of our commercial real estate loans in North Carolina, South Carolina, Florida, Tennessee and Virginia totaled \$699.2 million, \$303.6 million, \$794.4 million, \$596.0 million and \$15.8 million, respectively. At December 31, 2011, commercial real estate loans in all regions totaled \$2.4 billion (21% of which was owner occupied commercial real estate). We have recently tightened underwriting and pricing standards for indirect auto and residential mortgage lending and de-emphasized originations of commercial real estate mortgages.

We believe that early detection of potential credit problems through regular contact with our clients, coupled with consistent reviews of the borrowers' financial condition, are important factors in overall credit risk management. Our approach to proactively manage credit quality is to aggressively work with customers for whom a problem loan has been identified and assist in resolving issues before a default occurs.

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A key component of our growth strategy is to grow our loan portfolio by originating high-quality commercial and consumer loans, other than non-owner occupied real estate loans, that comply with our conservative credit policies and that produce revenues consistent with our financial objectives. From December 31, 2010 to December 31, 2011, the Bank's loan portfolio grew organically by \$107.9 million (or 6.2%

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annualized growth), excluding the initial increase in deposits resulting from the acquisitions of Capital Bank Corporation and Green Bankshares, Inc., with \$728.4 million in new originations partially offset by pay-downs, dispositions and charge-offs. Additionally, we are working to reduce excessive concentrations in commercial real estate, which characterized our acquisitions' legacy portfolios, in order to achieve a more diversified portfolio. It is our long-term goal to reduce the commercial real estate concentration to approximately 20% of our total loan portfolio.

In addition, we operate an indirect auto lending business which originates loans for new and used cars through relationships with dealers in Southwest Florida, Southeast Florida, the Florida Keys and Tennessee. Loans are approved subject to review of FICO credit scores, vehicle age, and loan-to-value. We are in the process of implementing an expert scoring model which will include additional proprietary underwriting factors. We set pricing for loans based on credit score, vehicle age, and loan term. As of December 31, 2011, we had \$87.2 million of indirect auto loans.

### **Deposits**

Deposits are the primary source of funds for lending and investing activities and their cost is the largest category of interest expense. Deposits are attracted principally from clients within our branch network through the offering of a wide selection of deposit instruments to individuals and businesses, including non-interest-bearing checking accounts, interest-bearing checking accounts, savings accounts, money market deposit accounts, certificates of deposit and individual retirement accounts. We are focused on reducing our reliance on high-cost certificates of deposit as a source of funds with low-cost deposit accounts. Deposit account terms vary with respect to the minimum balance required, the time period the funds must remain on deposit and service charge schedules. Interest rates paid on specific deposit types are determined based on (1) the interest rates offered by competitors, (2) the anticipated amount and timing of funding needs, (3) the availability and cost of alternative sources of funding and (4) the anticipated future economic conditions and interest rates. Client deposits are attractive sources of funding because of their stability and relatively low cost. Deposits are regarded as an important part of the overall client relationship and provide opportunities to cross-sell other services. In addition, we gather a portion of our deposit base through brokered deposits. At December 31, 2011, total deposits were \$5.1 billion of which \$5.0 billion (or 97%) were non-brokered deposits and \$143.1 million (or 3%) were brokered deposits. At December 31, 2011, our core deposits (total deposits less time deposits) consisted of \$683.3 million of non-interest checking accounts, \$1.1 billion of negotiable order of withdrawal accounts, \$296.4 million of savings accounts and \$868.4 million of money market deposits. For the foreseeable future, we remain focused on retaining and growing a strong deposit base and transitioning certain of our customers to low-cost banking services as high-cost funding sources, such as high-interest certificates of deposit, mature.

### **Investing Activities**

Investment securities represent a significant portion of Capital Bank, NA's assets. The Bank invests in securities as allowable under bank regulations. These securities include obligations of the U.S. Treasury, U.S. government agencies, U.S. government-sponsored entities, including mortgage-backed securities, bank eligible obligations of any state or political subdivision, privately-issued mortgage-backed securities, bank eligible corporate obligations, mutual funds and limited types of equity securities. Our investment activities are governed internally by a written, Board-approved policy. The investment policy is carried out by the Bank's Asset-Liability Committee (ALCO), which meets regularly to review the economic environment and establish investment strategies.

Investment strategies are reviewed by ALCO based on the interest rate environment, balance sheet mix, actual and anticipated loan demand, funding opportunities and the overall interest rate sensitivity of the Bank. In general, the investment portfolio is managed in a manner appropriate to the attainment of the following goals: (i) to provide a sufficient margin of liquid assets to meet unanticipated deposit and loan fluctuations and overall funds management objectives; (ii) to provide eligible securities to secure public funds and other borrowings; and (iii) to earn the maximum return on funds invested that is commensurate with meeting the requirements of (i) and (ii).

### **Marketing**

Our marketing activities support all of our products and services described above. Historically, most of our marketing efforts have supported our real estate mortgage, commercial and retail banking businesses. Our marketing strategy aims to:

capitalize on our personal relationship approach, which we believe differentiates us from our larger competitors in both the commercial and residential mortgage lending businesses;

meet our growth objectives based on current economic and market conditions;

attract core deposits held in checking, savings, money market and certificate of deposit accounts;

provide customers with access to our local executives;

appeal to customers in our region who value quality banking products and personal service;

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pursue commercial and industrial lending opportunities with small to mid-sized businesses that are underserved by our larger competitors;

cross-sell our products and services to our existing customers to leverage our relationships, grow fee income and enhance profitability;

utilize existing industry relationships cultivated by our senior management team; and

adhere to safe and sound credit standards.

We use a variety of targeted marketing media including the Internet, print, direct mail and financial newsletters. Our online marketing activities include paid advertising, as well as cross-sale marketing through our website and Internet banking services. We believe our marketing strategy will enable us to take advantage of lower average customer acquisition costs, build valuable brand awareness and lower our funding costs.

## **Information Technology Systems**

We have made and continue to make investments in our information technology systems for our banking and lending operations and cash management activities. We seek to integrate our acquisitions quickly and successfully and believe this is a necessary investment in order to enhance our capabilities to offer new products and overall customer experience and to provide scale for future growth and acquisitions. Our enhancements are tailored to improve our commercial and consumer loan origination, electronic banking and direct response marketing processes, as well as enhance cash management, streamlined reporting, reconciliation support and sales support. We work closely with certain third-party service providers to which we outsource certain of our systems and infrastructure. We use the Jack Henry SilverLake System as our banking platform and believe that the scalability of our infrastructure will support our growth strategy and that this platform will support our growth needs.

## **Competition**

The financial services industry in general and our primary markets of South Florida, Tennessee and the Carolinas are highly competitive. We compete actively with national, regional and local financial services providers, including banks, thrifts, credit unions, mortgage bankers and finance companies, money market mutual funds and other financial institutions, some of which are not subject to the same degree of regulation and restrictions imposed upon us. Our largest competitors include Bank of America, Wells Fargo, BB&T, First Citizens, Royal Bank of Canada, SunTrust, Regions, FNB United Corp., Toronto-Dominion, Synovus, First Financial, SCBT, JPMorgan Chase, Citigroup, EverBank, Fifth Third Bancorp, First Horizon, Pinnacle Financial, First South and U.S. Bancorp.

Competition among providers of financial products and services continues to increase, with consumers having the opportunity to select from a growing variety of traditional and nontraditional alternatives. The primary factors driving commercial and consumer competition for loans and deposits are interest rates, the fees charged, customer service levels and the range of products and services offered. In addition, other competitive factors include the location and hours of our branches and customer service.

## **Employees**

At December 31, 2011, Capital Bank had over 1,375 full-time employees and 165 part-time employees. None of our employees are parties to a collective bargaining agreement. We consider our relationship with our employees to be adequate.

## **Facilities and Real Estate**

Capital Bank currently leases approximately 263,000 square feet of office and operations space in North Carolina, Florida and South Carolina. We operate 35 branches in Florida, 31 in North Carolina, 13 in South Carolina, 63 in Tennessee and one in Virginia. Of these branches, 42 were leased and the rest were owned. In addition, the Company owns approximately 110,000 and leases approximately 100,000 square feet of non-branch office space. Management believes the terms of the various leases are consistent with market standards and were arrived at through arm's-length bargaining.

## **Related Person Transactions**

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Certain of the directors and executive officers of Capital Bank, NA, members of their immediate families and entities with which they are involved are customers of and borrowers from the Bank. As of December 31, 2011, total loans outstanding to directors and executive officers of the Bank, and their associates as a group, equaled approximately \$13.1 million. All outstanding loans and commitments included in such transactions were made in the ordinary course of business, on substantially the same terms, including interest rates and collateral, as those prevailing at the time in comparable transactions with persons not related to the Bank, and did not involve more than the normal risk of collectability or present other unfavorable features.

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Due to the Bank Merger, the Company reported no loans or deposits on its Consolidated Balance Sheet as of December 31, 2011.

### **SUPERVISION AND REGULATION**

The U.S. banking industry is highly regulated under federal and state law. These regulations affect the operations of the Company and its subsidiaries. Investors should understand that the primary objectives of the U.S. bank regulatory regime are the protection of depositors and consumers and maintaining the stability of the U.S. financial system, and not the protection of stockholders.

As a bank holding company, we are subject to supervision and regulation by the Federal Reserve. Our national bank subsidiary (which will be our sole bank subsidiary following the reorganization) is subject to supervision and regulation by the OCC, the Consumer Financial Protection Bureau (which we refer to as the CFPB) and the FDIC. In addition, we expect that the additional businesses that we may invest in or acquire will be regulated by various state and/or federal regulators, including the OCC, the Federal Reserve, the CFPB and the FDIC.

The description below summarizes certain elements of the applicable bank regulatory framework. This description is not intended to describe all laws and regulations applicable to us and our subsidiaries. Banking statutes, regulations and policies are continually under review by Congress and state legislatures and federal and state regulatory agencies and changes in them, including changes in how they are interpreted or implemented, could have material effects on our business. In addition to laws and regulations, state and federal bank regulatory agencies may issue policy statements, interpretive letters and similar written guidance applicable to us and our subsidiaries. These issuances also may affect the conduct of our business or impose additional regulatory obligations. The description is qualified in its entirety by reference to the full text of the statutes, regulations, policies, interpretive letters and other written guidance that are described.

#### **Bank Holding Company Regulations**

Any entity that acquires direct or indirect control of a bank must obtain prior approval of the Federal Reserve to become a bank holding company pursuant to the BHCA. As a bank holding company, we are subject to regulation under the BHCA and to examination, supervision and enforcement by the Federal Reserve. While subjecting us to supervision and regulation, we believe that being a bank holding company (as opposed to a non-controlling investor) broadens the investment opportunities available to us among public and private financial institutions, failing and distressed financial institutions, seized assets and deposits and FDIC auctions. Federal Reserve jurisdiction also extends to any company that is directly or indirectly controlled by a bank holding company, such as subsidiaries and other companies in which the bank holding company makes a controlling investment.

Statutes, regulations and policies could restrict our ability to diversify into other areas of financial services, acquire depository institutions and make distributions or pay dividends on our equity securities. They may also require us to provide financial support to any bank that we control, maintain capital balances in excess of those desired by management and pay higher deposit insurance premiums as a result of a general deterioration in the financial condition of Capital Bank or other depository institutions we control. They may also limit the fees and prices Capital Bank charges for its consumer services.



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### **Capital Bank, N.A. as a National Bank**

Capital Bank is a national bank and is subject to supervision (including regular examination) by its primary banking regulator, the OCC. Retail operations of the bank are also subject to supervision and regulation by the CFPB. Capital Bank's deposits are insured by the FDIC through the DIF up to applicable limits in the manner and extent provided by law. Capital Bank is subject to the Federal Deposit Insurance Act, as amended (which we refer to as the FDI Act), and FDIC regulations relating to deposit insurance and may also be subject to supervision by the FDIC under certain circumstances.

### ***OCC Operating Agreement and FDIC Order***

Capital Bank is subject to specific requirements pursuant to the OCC Operating Agreement, which it entered into with the OCC in connection with our acquisition of the Failed Banks. The OCC Operating Agreement requires, among other things, that Capital Bank maintain various financial and capital ratios and provide notice to, and obtain consent from, the OCC with respect to any additional failed bank acquisitions from the FDIC or the appointment of any new director or senior executive officer of Capital Bank.

Capital Bank (and, with respect to certain provisions, CBF) is also subject to the FDIC Order issued in connection with the FDIC's approval of our applications for deposit insurance for the Failed Banks. The FDIC Order requires, among other things, that during the first three years following our acquisition of the Failed Banks, Capital Bank must obtain the FDIC's approval before implementing certain compensation plans and submit updated business plans and reports of material deviations from those plans to the FDIC. Additionally, the FDIC Order requires that Capital Bank maintain Tier 1 common equity (a non-GAAP measure) to total assets of at least 10% during such three-year period and after such three-year period to remain well capitalized.

A failure by CBF or Capital Bank to comply with the requirements of the OCC Operating Agreement or the FDIC Order could subject CBF to regulatory sanctions; and failure to comply, or the objection, or imposition of additional conditions by the OCC or the FDIC, in connection with any materials or information submitted thereunder, could prevent CBF from executing its business strategy and negatively impact its business, financial condition, liquidity and results of operations. As of December 31, 2011, Capital Bank was in compliance with all of the material terms of the OCC Operating Agreement and FDIC Order.

### **Regulatory Notice and Approval Requirements for Acquisitions of Control**

We must generally receive federal regulatory approval before we can acquire an institution or business. Specifically, a bank holding company must obtain prior approval of the Federal Reserve in connection with any acquisition that results in the bank holding company owning or controlling more than 5% of any class of voting securities of a bank or another bank holding company. In acting on such applications of approval, the Federal Reserve considers, among other factors: the effect of the acquisition on competition; the financial condition and future prospects of the applicant and the banks involved; the managerial resources of the applicant and the banks involved; the convenience and needs of the community, including the record of performance under the CRA; the effect of the acquisition on the stability of the United States banking or financial system; and the effectiveness of the applicant in combating money laundering activities. Our ability to make investments in depository institutions will depend on our ability to obtain approval of the Federal Reserve. The Federal Reserve could deny our application based on the above criteria or other considerations. We may also be required to sell branches as a condition to receiving regulatory approval, which may not be acceptable to us or, if acceptable to us, may reduce the benefit of any acquisition.

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Federal and state laws impose additional notice, approval and ongoing regulatory requirements on any investor that seeks to acquire direct or indirect control of an FDIC-insured depository institution or bank holding company. These laws include the BHCA and the Change in Bank Control Act. Among other things, these laws require regulatory filings by an investor that seeks to acquire direct or indirect control of an FDIC-insured depository institution.

### **Broad Supervision and Enforcement Powers**

The Federal Reserve, the OCC and the FDIC have broad supervisory and enforcement authority with regard to bank holding companies and banks, including the power to conduct examinations and investigations, issue cease and desist orders, impose fines and other civil and criminal penalties, terminate deposit insurance and appoint a conservator or receiver. The CFPB similarly has broad regulatory supervision and enforcement authority with regard to consumer protection matters affecting us or our subsidiaries. Bank regulators regularly examine the operations of banks and bank holding companies. In addition, banks and bank holding companies are subject to periodic reporting and filing requirements.

Bank regulators have various remedies available if they determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity or other aspects of a banking organization's operations are unsatisfactory. The regulators may also take action if they determine that the banking organization or its management is violating or has violated any law or regulation. The regulators have the power to, among other things: enjoin unsafe or unsound practices, require affirmative actions to correct any violation or practice, issue administrative orders that can be judicially enforced, direct increases in capital, direct the sale of subsidiaries or other assets, limit dividends and distributions, restrict growth, assess civil monetary penalties, remove officers and directors and terminate deposit insurance.

Engaging in unsafe or unsound practices or failing to comply with applicable laws, regulations and supervisory agreements could subject the Company, its subsidiaries and their respective officers, directors and institution-affiliated parties to the remedies described above and other sanctions. In addition, the FDIC may terminate a bank's depository insurance upon a finding that the bank's financial condition is unsafe or unsound or that the bank has engaged in unsafe or unsound practices or has violated an applicable rule, regulation, order or condition enacted or imposed by the bank's regulatory agency.

### **Interstate Banking**

#### ***Interstate Banking for State and National Banks***

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act (which we refer to as the Riegle-Neal Act), a bank holding company may acquire banks in states other than its home state, subject to any state requirement that the bank has been organized and operating for a minimum period of time, not to exceed five years, and the requirement that the bank holding company not control, prior to or following the proposed acquisition, more than 10% of the total amount of deposits of insured depository institutions nationwide or, unless the acquisition is the bank holding company's initial entry into the state, more than 30% of such deposits in the state (or such lesser or greater amount set by the state). The Riegle-Neal Act also authorizes banks to merge across state lines, thereby creating interstate branches. The Dodd-Frank Act permits a national or state bank, with the approval of its regulator, to open a branch in any state if the law of the state in which the branch is located would permit the establishment of the branch if the bank were a bank chartered in that state. National banks may provide trust services in any state to the same extent as a trust company chartered by that state.

### **Limits on Transactions with Affiliates**

Federal law restricts the amount and the terms of both credit and non-credit transactions between a bank and its nonbank affiliates. Transactions with any single affiliate may not exceed 10% of the capital stock and surplus of the bank.

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### **Bank Holding Companies as a Source of Strength**

Federal Reserve law requires that a bank holding company serve as a source of financial and managerial strength to each bank that it controls and, under appropriate circumstances, to commit resources to support each such controlled bank.

Under the prompt corrective action provisions, if a controlled bank is undercapitalized, then the regulators could require the bank holding company to guarantee the bank's capital restoration plan. In addition, if the Federal Reserve believes that a bank holding company's activities, assets or affiliates represent a significant risk to the financial safety, soundness or stability of a controlled bank, then the Federal Reserve could require the bank holding company to terminate the activities, liquidate the assets or divest the affiliates. The regulators may require these and other actions in support of controlled banks even if such actions are not in the best interests of the bank holding company or its stockholders. Because we are a bank holding company, we (and our consolidated assets) are viewed as a source of financial and managerial strength for any controlled depository institutions, such as Capital Bank.

The Dodd-Frank Act also directs federal bank regulators to require that all companies that directly or indirectly control an insured depository institution serve as sources of financial strength for the institution. The term "source of financial strength" is defined under the Dodd-Frank Act as the ability of a company to provide financial assistance to its insured depository institution subsidiaries in the event of financial distress. The appropriate federal banking agency for such a depository institution may require reports from companies that control the insured depository institution to assess their abilities to serve as sources of strength and to enforce compliance with the source-of-strength requirements. The appropriate federal banking agency may also require a holding company to provide financial assistance to a bank with impaired capital. The Dodd-Frank Act requires that federal banking regulators propose implementing regulations no later than July 21, 2011. Under this requirement, in the future we could be required to provide financial assistance to Capital Bank should it experience financial distress. Based on our ownership of a national bank subsidiary, the OCC could assess us if the capital of Capital Bank were to become impaired. If we failed to pay the assessment within three months, the OCC could order the sale of our stock in Capital Bank to cover the deficiency.

In addition, capital loans by us to Capital Bank will be subordinate in right of payment to deposits and certain other indebtedness of Capital Bank. In the event of our bankruptcy, any commitment by us to a federal bank regulatory agency to maintain the capital of Capital Bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

### **Depositor Preference**

The FDI Act provides that, in the event of the liquidation or other resolution of an insured depository institution, the claims of depositors of the institution (including the claims of the FDIC as subrogee of insured depositors) and certain claims for administrative expenses of the FDIC as a receiver will have priority over other general unsecured claims against the institution. If our insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, nondeposit creditors, including us, with respect to any extensions of credit they have made to such insured depository institution.

### **Regulatory Capital Requirements**

#### ***In General***

Bank regulators view capital levels as important indicators of an institution's financial soundness. FDIC-insured depository institutions and their holding companies are required to maintain minimum capital relative to the amount and types of assets they hold. The final supervisory judgment on an institution's capital adequacy is based on the regulator's individualized assessment of numerous factors.

As a bank holding company, we are subject to various regulatory capital adequacy requirements administered by the Federal Reserve. In addition, the OCC imposes capital adequacy requirements on our subsidiary bank. The FDIC also may impose these requirements on Capital Bank and other depository institution subsidiaries that we may acquire or control in the future. The FDI Act requires that the federal regulatory agencies adopt regulations defining five capital tiers for banks: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. 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 our financial condition.

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Quantitative measures, established by the regulators to ensure capital adequacy, require that a bank holding company maintain minimum ratios of capital to risk-weighted assets. There are three categories of capital under the guidelines. With the implementation of the Dodd-Frank Act, certain changes have been made as to the type of capital that falls under each of these categories. For us, as a bank holding company, Tier 1 capital includes common shareholders' equity, qualifying preferred stock and trust preferred securities issued before May 19, 2010, less goodwill and certain other deductions (including a portion of servicing assets and the unrealized net gains and losses, after taxes, on securities available for sale). Tier 2 capital includes preferred stock and trust preferred securities not qualifying as Tier 1 capital, subordinated debt, the allowance for credit losses and net unrealized gains on marketable equity securities, subject to limitations by the guidelines. Tier 2 capital is limited to the amount of Tier 1 capital (*i.e.*, at least half of the total capital must be in the form of Tier 1 capital). Tier 3 capital includes certain qualifying unsecured subordinated debt. See Changes in Laws, Regulations or Policies and the Dodd-Frank Act.

Under the guidelines, capital is compared with the relative risk related to the balance sheet. To derive the risk included in the balance sheet, a risk weighting is applied to each balance sheet asset and off-balance sheet item, primarily based on the relative credit risk of the asset or counterparty. For example, claims guaranteed by the U.S. government or one of its agencies are risk-weighted at 0% and certain real estate-related loans risk-weighted at 50%. Off-balance sheet items, such as loan commitments and derivatives, are also applied a risk weight after calculating balance sheet equivalent amounts. A credit conversion factor is assigned to loan commitments based on the likelihood of the off-balance sheet item becoming an asset. For example, certain loan commitments are converted at 50% and then risk-weighted at 100%. Derivatives are converted to balance sheet equivalents based on notional values, replacement costs and remaining contractual terms. For certain recourse obligations, direct credit substitutes, residual interests in asset securitization and other securitized transactions that expose institutions primarily to credit risk, the capital amounts and classification under the guidelines are subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Banks and bank holding companies currently are required to maintain Tier 1 capital and the sum of Tier 1 and Tier 2 capital equal to at least 6% and 10%, respectively, of their total risk-weighted assets (including certain off-balance sheet items, such as standby letters of credit) to be deemed well capitalized. The federal bank regulatory agencies may, however, set higher capital requirements for an individual bank or when a bank's particular circumstances warrant. At this time, the bank regulatory agencies are more inclined to impose higher capital requirements in order to meet well-capitalized standards, and future regulatory change could impose higher capital standards as a routine matter.

The Federal Reserve may also set higher capital requirements for holding companies whose circumstances warrant it. For example, holding companies experiencing internal growth or making acquisitions are expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets. Also, the Federal Reserve considers a tangible Tier 1 leverage ratio (deducting all intangibles) and other indications of capital strength in evaluating proposals for expansion or engaging in new activities. In addition, the federal bank regulatory agencies have established minimum leverage (Tier 1 capital to adjusted average total assets) guidelines for banks within their regulatory jurisdictions. These guidelines provide for a minimum leverage ratio of 5% for banks to be deemed well capitalized. Our regulatory capital ratios and those of Capital Bank are in excess of the levels established for well-capitalized institutions.

As an additional means to identify problems in the financial management of depository institutions, the FDI Act requires federal bank regulatory agencies to establish certain non-capital safety and soundness standards for institutions for which they are the primary federal regulator. The standards relate generally to operations and management, asset quality, interest rate exposure and executive compensation. The agencies are authorized to take action against institutions that fail to meet such standards.

In addition, the Dodd-Frank Act requires the federal banking agencies to adopt capital requirements that address the risks that the activities of an institution pose to the institution and the public and private stakeholders, including risks arising from certain enumerated activities. The federal banking agencies may change existing capital guidelines or adopt new capital guidelines in the future pursuant to the Dodd-Frank Act, the implementation of Basel III (described below) or other regulatory or supervisory changes. We cannot be certain what the impact of changes to existing capital guidelines will have on us or Capital Bank.

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**Table of Contents****Basel I, Basel II and Basel III Accords**

The current risk-based capital guidelines that apply to us and our subsidiary bank are based on the 1988 capital accord, referred to as Basel I, of the International Basel Committee on Banking Supervision (which we refer to as the Basel Committee), a committee of central banks and bank supervisors, as implemented by federal bank regulators. In 2008, the bank regulatory agencies began to phase in capital standards based on a second capital accord issued by the Basel Committee, referred to as Basel II, for large or core international banks and bank holding companies (generally defined for U.S. purposes as having total assets of \$250 billion or more or consolidated foreign exposures of \$10 billion or more). Because we do not anticipate controlling any large or core international bank in the foreseeable future, Basel II will not apply to us.

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee, announced agreement on the calibration and phase in arrangements for a strengthened set of capital requirements, known as Basel III. While the timing and scope of any U.S. implementation of Basel III remains uncertain, the following items provide a brief description of the relevant provisions of Basel III and their potential impact on our capital levels if applied to us and Capital Bank.

**New Minimum Capital Requirements.** Subject to implementation by the U.S. federal banking agencies, Basel III would be expected, among other things, to increase required capital ratios of banking institutions to which it applies, as follows:

**Minimum Common Equity.** The minimum requirement for common equity, the highest form of loss absorbing capital, would be raised from the current 2.0% level, before the application of regulatory adjustments, to 3.5% as of January 11, 2013 and 4.5% by January 1, 2015 after the application of stricter adjustments. The capital conversion buffer, discussed below, would cause required total common equity to rise to 7.0% by January 1, 2019 (4.5% attributable to the minimum required common equity plus 2.5% attributable to the capital conservation buffer).

**Minimum Tier 1 Capital.** The minimum Tier 1 capital requirement, which includes common equity and other qualifying financial instruments based on stricter criteria, would increase from 4.0% to 4.5% by January 1, 2013, and 6.0% by January 1, 2015. Total Tier 1 capital would rise to 8.5% by January 1, 2019 (6.0% attributable to the minimum required Tier 1 capital ratio plus 2.5% attributable to the capital conservation buffer, as discussed below).

**Minimum Total Capital.** The minimum Total Capital (Tier 1 and Tier 2 capital) requirement would increase to 8.0% (10.5% by January 1, 2019, including the capital conservation buffer).

**Capital Conservation Buffer.** The capital conservation buffer would add 2.5% to the regulatory minimum common equity requirement (adding 0.625% during each of the three years beginning in January 1, 2016 through January 1, 2019). The buffer would be added to common equity, after the application of deductions. The purpose of the conservation buffer is to ensure that banks maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. It is expected that, while banks would be allowed to draw on the buffer during such periods of stress, the closer their regulatory capital ratios approach the minimum requirement, the greater the constraints that would be applied to earnings distributions.

**Countercyclical Buffer.** Basel III expects regulators to require, as appropriate to national circumstances, a countercyclical buffer within a range of 0% to 2.5% of common equity or other fully loss-absorbing capital. The purpose of the countercyclical buffer is to achieve the broader goal of protecting the banking sector from periods of excess aggregate credit growth. For any given country, it is expected that this buffer would only be applied when there is excess credit growth that is resulting in a perceived system-wide buildup of risk. The countercyclical buffer, when in effect, would be introduced as an extension of the capital conservation buffer range.

**Regulatory Deductions from Common Equity.** The regulatory adjustments (*i.e.*, deductions and prudential filters), including minority interests in financial institutions, mortgage-servicing rights, and deferred tax assets from timing differences, would be deducted in increasing percentages beginning January 1, 2014, and would be fully deducted from common equity by January 1,

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2018. Certain instruments that no longer qualify as Tier 1 capital, such as trust preferred securities, also would be subject to phaseout over a 10-year period beginning January 1, 2013.

***Non-Risk-Based Leverage Ratios.*** These capital requirements are supplemented by a non-risk-based leverage ratio that will serve as a backstop to the risk-based measures described above. In July 2010, the Governors and Heads of Supervision agreed to test a minimum Tier 1 leverage ratio of 3.0% during the parallel run period. Based on the results of the parallel run period, any final adjustments would be carried out in the first half of 2017 with a view to adopting the 3.0% leverage ratio on January 1, 2018, based on appropriate review and calibration.

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Basel III also introduces a non-risk adjusted Tier 1 leverage ratio of 3%, based on a measure of total exposure that includes balance sheet assets, net of provisions and valuation adjustments, as well as potential future exposure to off-balance sheet items, such as derivatives. Basel III also includes both short- and long-term liquidity standards. The phase-in of the new rules is to commence on January 1, 2013, with the phase-in of the capital conservation buffer commencing on January 1, 2016 and the rules to be fully phased in by January 1, 2019.

In November 2010, Basel III was endorsed by the Group of Twenty (G-20) Finance Ministers and Central Bank Governors and will be subject to individual adoption by member nations, including the United States. On December 16, 2010, the Basel Committee issued the text of the Basel III rules, which presents the details of global regulatory standards on bank capital adequacy and liquidity agreed by the Basel Committee and endorsed by the G-20 leaders. In January 2011, the Basel Committee issued further guidance on the qualification criteria for inclusion in Tier 1 capital. The federal banking agencies will likely implement changes to the current capital adequacy standards applicable to us and our bank subsidiary in light of Basel III. If adopted by federal banking agencies, Basel III could lead to higher capital requirements, including a restrictive leverage ratio and new liquidity ratios. The ultimate impact of the new capital and liquidity standards on us and our bank subsidiary is currently being reviewed and will depend on a number of factors, including the rule-making and implementation by the U.S. banking regulators.

### **Prompt Corrective Action**

The FDI Act requires federal bank regulatory agencies to take prompt corrective action with respect to FDIC-insured depository institutions that do not meet minimum capital requirements. A depository institution's treatment for purposes of the prompt corrective action provisions will depend upon how its capital levels compare to various capital measures and certain other factors, as established by regulation.

Under this system, the federal banking regulators have established five capital categories, well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, in which all institutions are placed. The federal banking regulators have also specified by regulation the relevant capital levels for each of the other categories. Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized.

Federal Reserve Board regulations require that each bank maintain reserve balances on deposits with the Federal Reserve Bank.

### **Reserve Requirements**

Pursuant to regulations of the Federal Reserve, all banks are required to maintain average daily reserves at mandated ratios against their transaction accounts. In addition, reserves must be maintained on certain non-personal time deposits. These reserves must be maintained in the form of vault cash or in an account at a Federal Reserve Bank.

### **Deposit Insurance Assessments**

FDIC-insured banks are required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. The FDIC recently raised assessment rates to increase funding for the DIF, which is currently underfunded.

The Dodd-Frank Act makes permanent the general \$250,000 deposit insurance limit for insured deposits. In addition, federal deposit insurance for the full net amount of deposits in non-interest-bearing transaction accounts was extended to January 1, 2013 for all insured banks.

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The Dodd-Frank Act changes the deposit insurance assessment framework, primarily by basing assessments on an institution's total assets less tangible equity (subject to risk-based adjustments that would further reduce the assessment base for custodial banks) rather than domestic deposits, which is expected to shift a greater portion of the aggregate assessments to large banks, as described in detail below. The Dodd-Frank Act also eliminates the upper limit for the reserve ratio designated by the FDIC each year, increases the minimum designated reserve ratio of the DIF from 1.15% to 1.35% of the estimated amount of total insured deposits by September 30, 2020, and eliminates the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds.

The Dodd-Frank Act requires the DIF to reach a reserve ratio of 1.35% of insured deposits by September 30, 2020. On December 20, 2010, the FDIC raised the minimum designated reserve ratio of DIF to 2%. The ratio is higher than the minimum reserve ratio of 1.35% as set by the Dodd-Frank Act. Under the Dodd-Frank Act, the FDIC is required to offset the effect of the higher reserve ratio on insured depository institutions with consolidated assets of less than \$10 billion.

On February 7, 2011, the FDIC approved a final rule on Assessments, Dividends, Assessment Base and Large Bank Pricing. The final rule, mandated by the Dodd-Frank Act, changes the deposit insurance assessment system from one that is based on domestic deposits to one that is based on average consolidated total assets minus average tangible equity. Because the new assessment base under the Dodd-Frank Act is larger than the current assessment base, the final rule's assessment rates are lower than the current rates, which achieves the FDIC's goal of not significantly altering the total amount of revenue collected from the industry. In addition, the final rule adopts a scorecard assessment scheme for larger banks and suspends dividend payments if the DIF reserve ratio exceeds 1.5% but provides for decreasing assessment rates when the DIF reserve ratio reaches certain thresholds. The final rule also determines how the effect of the higher reserve ratio will be offset for institutions with less than \$10 billion of consolidated assets.

Continued action by the FDIC to replenish the DIF as well as changes contained in the Dodd-Frank Act may result in higher assessment rates. Capital Bank may be able to pass part or all of this cost on to its customers, including in the form of lower interest rates on deposits, or fees to some depositors, depending on market conditions.

The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. If deposit insurance for a banking business we invest in or acquire were to be terminated, that would have a material adverse effect on that banking business and potentially on the Company as a whole.

### **Permitted Activities and Investments by Bank Holding Companies**

The BHCA generally prohibits a bank holding company from engaging in activities other than banking or managing or controlling banks except for activities determined by the Federal Reserve to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Provisions of the Gramm-Leach-Bliley Financial Modernization Act of 1999 (which we refer to as the GLB Act) expanded the permissible activities of a bank holding company that qualifies as a financial holding company. Under the regulations implementing the GLB Act, a financial holding company may engage in additional activities that are financial in nature or incidental or complementary to financial activity. Those activities include, among other activities, certain insurance and securities activities. We have not yet determined whether it would be appropriate or advisable in the future to become a financial holding company.



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### **Privacy Provisions of the GLB Act and Restrictions on Cross-Selling**

Federal banking regulators, as required under the GLB Act, have adopted rules limiting the ability of banks and other financial institutions to disclose nonpublic information about consumers to nonaffiliated third parties. The rules require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to nonaffiliated third parties. The privacy provisions of the GLB Act affect how consumer information is transmitted through diversified financial services companies and conveyed to outside vendors.

Federal financial regulators have issued regulations under the Fair and Accurate Credit Transactions Act, which have the effect of increasing the length of the waiting period, after privacy disclosures are provided to new customers, before information can be shared among different companies that we own or may come to own for the purpose of cross-selling products and services among companies we own. A number of states have adopted their own statutes concerning financial privacy and requiring notification of security breaches.

### **Anti-Money Laundering Requirements**

Under federal law, including the Bank Secrecy Act, the PATRIOT Act and the International Money Laundering Abatement and Anti-Terrorist Financing Act, certain types of financial institutions, including insured depository institutions, must maintain anti-money laundering programs that include established internal policies, procedures and controls; a designated compliance officer; an ongoing employee training program; and testing of the program by an independent audit function. Among other things, these laws are intended to strengthen the ability of U.S. law enforcement agencies and intelligence communities to work together to combat terrorism on a variety of fronts. Financial institutions are prohibited from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence and customer identification in their dealings with non-U.S. financial institutions and non-U.S. customers. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious information maintained by financial institutions. Bank regulators routinely examine institutions for compliance with these obligations and they must consider an institution's compliance in connection with the regulatory review of applications, including applications for banking mergers and acquisitions. The regulatory authorities have imposed cease and desist orders and civil money penalty sanctions against institutions found to be violating these obligations.

The OFAC is responsible for helping to insure that U.S. entities do not engage in transactions with certain prohibited parties, as defined by various Executive Orders and Acts of Congress. OFAC publishes lists of persons, organizations and countries suspected of aiding, harboring or engaging in terrorist acts, known as Specially Designated Nationals and Blocked Persons. If we or Capital Bank find a name on any transaction, account or wire transfer that is on an OFAC list, we or Capital Bank must freeze or block such account or transaction, file a suspicious activity report and notify the appropriate authorities.

### **Consumer Laws and Regulations**

Banks and other financial institutions are subject to numerous laws and regulations intended to protect consumers in their transactions with banks. These laws include, among others, laws regarding unfair and deceptive acts and practices and usury laws, as well as the following consumer protection statutes: Truth in Lending Act, Truth in Savings Act, Electronic Funds Transfer Act, Expedited Funds Availability Act, Equal Credit Opportunity Act, Fair and Accurate Credit Transactions Act, Fair Housing Act, Fair Credit Reporting Act, Fair Debt Collection Act, GLB Act, Home Mortgage Disclosure Act, Right to Financial Privacy Act and Real Estate Settlement Procedures Act.

Many states and local jurisdictions have consumer protection laws analogous, and in addition, to those listed above. These federal, state and local laws regulate the manner in which financial institutions deal with customers when taking deposits, making loans or conducting other types of transactions. Failure to comply with these laws and regulations could give rise to regulatory sanctions, customer rescission rights, action by state and local attorneys general and civil or criminal liability.

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The Dodd-Frank Act creates the CFPB, a new independent bureau that will have broad authority to regulate, supervise and enforce retail financial services activities of banks and various non-bank providers. The CFPB will have authority to promulgate regulations, issue orders, guidance and policy statements, conduct examinations and bring enforcement actions with regard to consumer financial products and services. In general, banks with assets of \$10 billion or less, such as Capital Bank, will be subject to regulation of the CFPB but will continue to be examined for consumer compliance by their bank regulator. However, given our growth and bank acquisition strategy, if our total assets were to exceed \$10 billion, then we will become subject to the CFPB's exclusive examination authority and primary enforcement authority.

### **The Community Reinvestment Act**

The CRA is intended to encourage banks to help meet the credit needs of their service areas, including low- and moderate-income neighborhoods, consistent with safe and sound operations. The regulators examine banks and assign each bank a public CRA rating. A bank's record of fair lending compliance is part of the resulting CRA examination report. The CRA then requires bank regulators to take into account the bank's record in meeting the needs of its service area when considering an application by a bank to establish a branch or to conduct certain mergers or acquisitions. The Federal Reserve is required to consider the CRA records of a bank holding company's controlled banks when considering an application by the bank holding company to acquire a bank or to merge with another bank holding company.

When we apply for regulatory approval to make certain investments, the regulators will consider the CRA record of the target institution and our depository institution subsidiary. An unsatisfactory CRA record could substantially delay approval or result in denial of an application.

### **Changes in Laws, Regulations or Policies and the Dodd-Frank Act**

Various federal, state and local legislators introduce from time to time measures or take actions that would modify the regulatory requirements or the examination or supervision of banks or bank holding companies. Such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks and other financial institutions, all of which could affect our investment opportunities and our assessment of how attractive such opportunities may be. We cannot predict whether potential legislation will be enacted and, if enacted, the effect that it or any implementing regulations would have on our business, results of operations or financial condition.

The Dodd-Frank Act, which was signed into law on July 21, 2010, will have a broad impact on the financial services industry, imposing significant regulatory and compliance changes, increased capital, leverage and liquidity requirements and numerous other provisions designed to improve supervision and oversight of the financial services sector. The following items briefly describe some of the key provisions of the Dodd-Frank Act:

***Source of Strength.*** The Dodd-Frank Act requires all companies that directly or indirectly control a depository institution to serve as a source of strength for the institution.

***Limitation on Federal Preemption.*** The Dodd-Frank Act may limit the ability of national banks to rely upon federal preemption of state consumer financial laws. Under the Dodd-Frank Act, the OCC will have the ability to make preemption determinations only if certain conditions are met and on a case-by-case basis. The Dodd-Frank Act also eliminates the extension of preemption to operating subsidiaries of national banks. However, the Dodd-Frank Act preserves certain preemption standards articulated by the U.S. Supreme Court and existing interpretations thereunder, as well as express preemption provisions in other federal laws (such as the Equal Credit Opportunity Act and the Truth in Lending Act) that specifically address the application of state law in relation to that federal law. The Dodd-Frank Act authorizes state enforcement authorities to bring lawsuits under state law against national banks and authorizes suits by state attorney generals against national banks to enforce rules issued by the CFPB. With this broad grant of enforcement authority to states, institutions, including national banks, could be subject to varying and potentially conflicting interpretations of federal law by various state attorney generals, state regulators and the courts.

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***Mortgage Loan Origination and Risk Retention.*** The Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks, in an effort to require steps to verify a borrower's ability to repay. The Dodd-Frank Act also generally requires lenders or securitizers to retain an economic interest in the credit risk relating to loans the lender sells or mortgages and other asset-backed securities that the securitizer issues. The risk retention requirement generally will be 5%, but could be increased or decreased by regulation.

***Consumer Financial Protection Bureau.*** The Dodd-Frank Act creates the CFPB within the Federal Reserve. The CFPB is tasked with establishing and implementing rules and regulations under certain federal consumer protection laws with respect to the conduct of providers of certain consumer financial products and services. The CFPB has rulemaking authority over many of the statutes governing products and services offered to bank customers. For banking organizations with assets of more than \$10 billion, the CFPB has exclusive rule-making and examination and primary enforcement authority under federal consumer financial laws. In addition, the Dodd-Frank Act permits states to adopt consumer protection laws and regulations that are stricter than those regulations promulgated by the CFPB.

***Deposit Insurance.*** The Dodd-Frank Act makes permanent the general \$250,000 deposit insurance limit for insured deposits. The Dodd-Frank Act also provides unlimited deposit coverage for noninterest-bearing transaction accounts until January 1, 2013. Amendments to the FDI Act also revise the assessment base against which an insured depository institution's deposit insurance premiums paid to the DIF will be calculated. Under these amendments, the assessment base will no longer be the institution's deposit base, but rather its average consolidated total assets less its average tangible equity. Additionally, the Dodd-Frank Act makes changes to the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15% to 1.35% of the estimated amount of total insured deposits and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds.

***Transactions with Affiliates and Insiders.*** The Dodd-Frank Act generally enhances the restrictions on transactions with affiliates under Sections 23A and 23B of the Federal Reserve Act, including an expansion of the definition of covered transactions and an increase in the amount of time for which collateral requirements regarding covered credit transactions must be satisfied. Insider transaction limitations are expanded through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivatives transactions, repurchase agreements, reverse repurchase agreements and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution's board of directors.

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**Corporate Governance.** The Dodd-Frank Act addresses many investor protection, corporate governance and executive compensation matters that will affect most U.S. publicly traded companies, including the Company. The Dodd-Frank Act (1) grants stockholders of U.S. publicly traded companies an advisory vote on executive compensation; (2) enhances independence requirements for compensation committee members; (3) requires companies listed on national securities exchanges to adopt incentive-based compensation clawback policies for executive officers; and (4) provides the SEC with authority to adopt proxy access rules that would allow stockholders of publicly traded companies to nominate candidates for election as a director and have those nominees included in a company's proxy materials.

**Interchange Fees.** Under the so-called Durbin Amendment of the Dodd-Frank Act, interchange transaction fees that a card issuer receives or charges for an electronic debit transaction must be reasonable and proportional to the cost incurred by the card issuer in processing the transaction. Banks that have less than \$10 billion in assets are exempt from the interchange transaction fee limitation. On June 29, 2011, the Federal Reserve issued a final rule establishing standards for determining whether the amount of any interchange transaction fee is reasonable and proportional, taking into consideration fraud prevention costs, and prescribing regulations to ensure that network fees are not used, directly or indirectly, to compensate card issuers with respect to electronic debit transactions or to circumvent or evade the restrictions that interchange transaction fees be reasonable and proportional. Under the final rule, the maximum permissible interchange fee that an issuer may receive for an electronic debit will be the sum of \$0.21 per transaction and five basis points multiplied by the value of the transaction. The Federal Board also approved on June 29, 2011 an interim final rule that allows for an upward adjustment of no more than \$0.01 to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards set out in the interim final rule. The Dodd-Frank Act also bans card issuers and payment card networks from entering into exclusivity arrangements for debit card processing and prohibits card issuers and payment networks from inhibiting the ability of merchants to direct the routing of debit card transactions over networks of their choice. Finally, merchants will be able to set minimum dollar amounts for the use of a credit card and provide discounts to consumers who pay with various payment methods, such as cash.

Many of the requirements of the Dodd-Frank Act will be implemented over time, and most will be subject to regulations implemented over the course of several years. Given the uncertainty surrounding the manner in which many of the Dodd-Frank Act's provisions will be implemented by the various regulatory agencies and through regulations, the full extent of the impact on our operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business.

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**Statistical Information**

Certain statistical information is found in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of this Annual Report on Form 10-K.

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**ITEM 1A. RISK FACTORS.**

**RISK FACTORS**

*In addition to the other information included in and incorporated by reference into this document, including the matters addressed in Cautionary Note Regarding Forward-Looking Statements, you should carefully consider the following risk factors.*

Our business is subject to a variety of risks, including the risks described below as well as adverse business conditions and changes in regulations and the local, regional and national economic environment. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties not known to us or not described below which we have not determined to be material may also impair our business operations. You should carefully consider the risks described below, together with all other information in this report, including information contained in the Business, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Quantitative and Qualitative Disclosures about Market Risk sections. This report contains forward-looking statements that involve risks and uncertainties, including statements about our future plans, objectives, intentions and expectations. Many factors, including those described below, could cause actual results to differ materially from those discussed in forward-looking statements. If any of the following risks actually occur, our business, financial condition and results of operations could be adversely affected, and we may not be able to achieve our goals. Such events may cause actual results to differ materially from expected and historical results, and the trading price of our common stock could decline.

**Risks Relating to the Merger**

*The merger has been approved without your vote.*

CBF owns over 90% of the common stock of Green Bankshares, Inc.. Accordingly, under Tennessee law, no vote of Green Bankshares' Board of Directors or shareholders is required to complete the merger. As a result, the merger may be completed even if opposed by all of the Green Bankshares, Inc. shareholders unaffiliated with CBF.

*Neither CBF nor Green Bankshares, Inc. has hired anyone to represent you and we have a conflict of interest in the merger.*

CBF and the Company have not (1) negotiated the merger at arm's length or (2) hired independent persons to negotiate the terms of the merger for you. Since CBF initiated and structured the merger without negotiating with the Company or any independent person and CBF has an interest in acquiring your shares at the lowest possible price, if independent persons had been hired, the terms of the merger may have been more favorable to you.

*Because there is currently no market for CBF Class A common stock and a market for CBF Class A common stock may not develop, you cannot be sure of the market value of the merger consideration you will receive.*

Upon completion of the merger, each share of the Company's common stock will be converted into merger consideration consisting of 0.0915 of a share of CBF's Class A common stock. Prior to the initial public offering of CBF's Class A common stock, which is expected to be completed substantially concurrently with the merger, there has been no established public market for CBF's Class A common stock. An active, liquid trading market for CBF's Class A common stock may not develop or be sustained following the initial public offering. If an active trading market does not develop, holders of CBF's Class A common stock may have difficulty selling their shares at an attractive price, or at all. CBF has applied to have its Class A common stock listed on Nasdaq, but its application may not be approved. In addition, the liquidity of any market that may develop or the price that CBF's stockholders may obtain for their shares of Class A common stock cannot be predicted. The initial public offering price for CBF's Class A common stock will be determined by negotiations between CBF, its stockholders who choose to sell their shares in the initial public offering and the representative of the underwriters and may not be indicative of prices that will prevail in the open market following the offering.

The outcome of CBF's initial public offering will affect the market value of the consideration the Company's shareholders will receive upon completion of the merger. Accordingly, you will not know or be able to calculate the market value of the merger consideration you would receive upon completion of the merger. There will be no adjustment to the exchange ratio for changes in the anticipated outcome of CBF's initial public offering or changes in the market price of the Company's common stock.

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*If CBF completes the merger without completing its initial public offering, the size of the outstanding public float of CBF's Class A common stock will be low and the value and liquidity of CBF's common stock may be adversely affected.*

While the merger is expected to be completed substantially concurrently with CBF's initial public offering, CBF controls when the merger will take place and there can be no guarantee that CBF's initial public offering will occur substantially concurrently with the merger or at all. If the merger is completed and CBF's initial public offering is delayed or does not occur, there will be fewer publicly traded shares of CBF's Class A common stock outstanding than if the initial public offering is completed as anticipated and, as a result, the value and liquidity of CBF's shares of Class A common stock that you receive in the merger may be adversely affected.

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*The shares of CBF Class A common stock to be received by Green Bankshares, Inc. shareholders as a result of the merger will have different rights than the shares of Green Bankshares, Inc. common stock.*

The rights associated with Green Bankshares, Inc. common stock are different from the rights associated with CBF's Class A common stock. For example, certain business combinations between Green Bankshares, Inc. and any holder of more than 10% Green Bankshares, Inc. common stock must be approved by holders of at least 80% of the outstanding Green Bankshares, Inc. common stock as well as holders of at least a majority of the shares not held by shareholder engaging in the transaction (these provisions do not apply to the merger because the merger was approved by all members of the Board of Directors of Green Bankshares, Inc.). These provisions do not apply to CBF shareholders. In addition, holders of at least 10% of Green Bankshares, Inc. common stock may call a special meeting of Green Bankshares, Inc. shareholders, whereas special meetings of CBF shareholders can only be called by CBF's Chairman, Chief Executive Officer or its Board of Directors.

### **Risks Relating to the Company's Banking Operations**

*Continued or worsening general business and economic conditions could have a material adverse effect on CBF's business, financial position, results of operations and cash flows.*

Our business and operations are sensitive to general business and economic conditions in the United States. If the U.S. economy is unable to steadily emerge from the recent recession that began in 2007 or we experience worsening economic conditions, such as a so-called "double-dip" recession, our growth and profitability could be adversely affected. Weak economic conditions may be characterized by deflation, fluctuations in debt and equity capital markets, including a lack of liquidity and/or depressed prices in the secondary market for mortgage loans, increased delinquencies on mortgage, consumer and commercial loans, residential and commercial real estate price declines and lower home sales and commercial activity. All of these factors would be detrimental to our business. On August 5, 2011, Standard & Poor's lowered the long-term sovereign credit rating of U.S. Government debt obligations from AAA to AA+. On August 8, 2011, S&P also downgraded the long-term credit ratings of U.S. government-sponsored enterprises. These actions initially have had an adverse effect on financial markets and although we are unable to predict the longer-term impact on such markets and the participants therein, it may be material and adverse.

In addition, significant concern regarding the creditworthiness of some of the governments in Europe, most notably Greece, has contributed to volatility in financial markets in Europe and globally, and to funding pressures on some globally active European banks, leading to greater investor and economic uncertainty worldwide. A failure to adequately address sovereign debt concerns in Europe could hamper economic recovery or contribute to a return to recessionary economic conditions and severe stress in the financial markets, including in the United States.

Our business is also significantly affected by monetary and related policies of the U.S. federal government, its agencies and government-sponsored entities. Changes in any of these policies are influenced by macroeconomic conditions and other factors that are beyond our control, are difficult to predict and could have a material adverse effect on our business, financial position, results of operations and cash flows.

*The geographic concentration of our markets in the southeastern region of the United States makes our business highly susceptible to downturns in the local economies and depressed banking markets, which could be detrimental to our financial condition.*

Unlike larger financial institutions that are more geographically diversified, Capital Bank is a regional banking franchise concentrated in the southeastern region of the United States. Capital Bank operates branches located in Florida, North Carolina, South Carolina, Tennessee and Virginia. As of December 31, 2011, 32% of Capital Bank's loans were in Florida, 26% were in North Carolina, 12% were in South Carolina, 29% were in Tennessee and 1% was in Virginia. A deterioration in local economic conditions in the loan market or in the residential, commercial or industrial real estate market could have a material adverse effect on the quality of Capital Bank's portfolio, the demand for its products and services, the ability of borrowers to timely repay loans and the value of the collateral securing loans. In addition, if the population or income growth in the region is slower than projected, income levels, deposits and real estate development could be adversely affected and could result in the curtailment of our expansion, growth and profitability. If any of these developments were to result in losses that materially and adversely affected Capital Bank's capital, the Company and Capital Bank might be subject to regulatory restrictions on operations and growth and to a requirement to raise additional capital.

*We depend on our executive officers and key personnel to continue the implementation of its long-term business strategy and could be harmed by the loss of their services.*

We believe that our continued growth and future success will depend in large part on the skills of our management team and its ability to motivate and retain these individuals and other key personnel. In particular, we rely on the leadership and experience in the banking industry of its Chief Executive Officer, R. Eugene Taylor. Mr. Taylor is the former Vice Chairman of Bank of America and has extensive experience



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executing and overseeing bank acquisitions, including NationsBank Corp. s acquisition and integration of Bank of America, Maryland National Bank and Barnett Banks. The loss of service of Mr. Taylor or one or more of our other executive officers or key personnel could reduce our ability to successfully implement our

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long-term business strategy, our business could suffer and the value of our and CBF's common stock could be materially adversely affected. Leadership changes will occur from time to time and we cannot predict whether significant resignations will occur or whether we or CBF will be able to recruit additional qualified personnel. We believe our management team possesses valuable knowledge about the banking industry and that their knowledge and relationships would be very difficult to replicate. Although R. Eugene Taylor has entered into an employment agreement with CBF and it is expected that, prior to the completion of the initial public offering, Christopher G. Marshall, R. Bruce Singletary and Kenneth A. Posner will have entered into employment agreements with CBF, it is possible that they may not complete the term of their employment agreements or renew them upon expiration. Our success also depends on the experience of Capital Bank's branch managers and lending officers and on their relationships with the customers and communities they serve. The loss of these key personnel could negatively impact our banking operations. The loss of key personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business, financial condition or operating results.

***Capital Bank's loss sharing agreements impose restrictions on the operation of its business; failure to comply with the terms of the loss sharing agreements with the FDIC or other regulatory agreements or orders may result in significant losses or regulatory sanctions, and Capital Bank is exposed to unrecoverable losses on the Failed Banks' assets that it acquired.***

In July 2010, Capital Bank purchased substantially all of the assets and assumed all of the deposits and certain other liabilities of the Failed Banks in FDIC-assisted transactions, and a material portion of its revenue is derived from such assets. Certain of the purchased assets are covered by the loss sharing agreements with the FDIC, which provide that the FDIC will bear 80% of losses on the covered loan assets acquired in the acquisition of the Failed Banks. Capital Bank is subject to audit by the FDIC at its discretion to ensure it is in compliance with the terms of these agreements. Capital Bank may experience difficulties in complying with the requirements of the loss sharing agreements, the terms of which are extensive and failure to comply with any of the terms could result in a specific asset or group of assets losing their loss sharing coverage.

The FDIC has the right to refuse or delay payment partially or in full for such loan losses if Capital Bank fails to comply with the terms of the loss sharing agreements, which are extensive. Additionally, the loss sharing agreements are limited in duration. Therefore, any losses that Capital Bank experiences after the terms of the loss sharing agreements have ended will not be recoverable from the FDIC, and would negatively impact net income.

Capital Bank's loss sharing agreements also impose limitations on how it manages loans covered by loss sharing. For example, under the loss sharing agreements, Capital Bank is not permitted to sell a covered loan even if in the ordinary course of business it is determined that taking such action would be advantageous. These restrictions could impair Capital Bank's ability to manage problem loans and extend the amount of time that such loans remain on its balance sheet and could negatively impact Capital Bank's business, financial condition, liquidity and results of operations.

In addition to the loss sharing agreements, in August 2010, Capital Bank entered into an Operating Agreement with the OCC (which we refer to as the "OCC Operating Agreement"), in connection with the acquisition of the Failed Banks. Capital Bank (and, with respect to certain provisions, the Company and CBF) is also subject to an Order of the FDIC, dated July 16, 2010 (which we refer to as the "FDIC Order") issued in connection with the FDIC's approval of CBF's deposit insurance applications for the Failed Banks. The OCC Operating Agreement and the FDIC Order require that Capital Bank maintain various financial and capital ratios and require prior regulatory notice and consent to take certain actions in connection with operating the business and they restrict Capital Bank's ability to pay dividends to CBF and the Company and to make changes to its capital structure. A failure by CBF or Capital Bank to comply with the requirements of the OCC Operating Agreement or the FDIC Order could subject CBF to regulatory sanctions; and failure to comply, or the objection, or imposition of additional conditions, by the OCC or the FDIC, in connection with any materials or information submitted thereunder, could prevent CBF from executing our business strategy and negatively impact its business, financial condition, liquidity and results of operations.

***Any requested or required changes in how we determine the impact of loss share accounting on its financial information could have a material adverse effect on our reported results.***

A material portion of our financial results is based on loss share accounting, which is subject to assumptions and judgments made by us, our accountants and the regulatory agencies to whom we report such information. Loss share accounting is a complex accounting methodology. If these assumptions are incorrect or the accountants or the regulatory agencies to whom CBF and Capital Bank report require that management change or modify these assumptions, such change or modification could have a material adverse effect on our financial condition, operations or previously reported results. As such, any financial information generated through the use of loss share accounting is subject to modification or change. Any significant modification or change in such information could have a material adverse effect on our results of operations and our previously reported results.



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*Our financial information reflects the application of the acquisition method of accounting. Any change in the assumptions used in such methodology could have an adverse effect on our results of operations.*

As a result of CBF's recent acquisition, of us, our financial results are heavily influenced by the application of the acquisition method of accounting. The acquisition method of accounting requires management to make assumptions regarding the assets purchased and liabilities assumed to determine their fair market value. Capital Bank's interest income, interest expense and net interest margin (which were equal to \$226.4 million, \$32.8 million and 3.41%, respectively, for the year ended December 31, 2011) reflect the impact of accretion of the fair value adjustments made to the carrying amounts of interest earning assets and interest bearing liabilities and Capital Bank's non-interest income (which totaled \$40.7 million as of December 31, 2011) for periods subsequent to the acquisitions includes the effects of discount accretion and amortization of the FDIC indemnification asset. In addition, the balances of non-performing assets were significantly reduced by the adjustments to fair value recorded in conjunction with the relevant acquisition. If our assumptions are incorrect or the regulatory agencies to whom we report require that we change or modify its assumptions, such change or modification could have a material adverse effect on our financial condition or results of operations or our previously reported results.

*Our business is highly susceptible to credit risk.*

As a lender, Capital Bank is exposed to the risk that its customers will be unable to repay their loans according to their terms and that the collateral (if any) securing the payment of their loans may not be sufficient to assure repayment. The risks inherent in making any loan include risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting and guidelines, risks resulting from changes in economic and industry conditions, risks inherent in dealing with individual borrowers and risks resulting from uncertainties as to the future value of collateral. The credit standards, procedures and policies that Capital Bank has established for borrowers may not prevent the incurrence of substantial credit losses.

Although Capital Bank does not have a long enough operating history to have restructured many of its loans for borrowers in financial difficulty, in the future, it may restructure originated or acquired loans if Capital Bank believes the borrowers have a viable business plan to fully pay off all obligations. However, for its originated loans, if interest rates or other terms are modified upon extension of credit or if terms of an existing loan are renewed in such a situation and a concession is granted, Capital Bank may be required to classify such action as a troubled debt restructuring (which we refer to as a TDR). Capital Bank would classify loans as TDRs when certain modifications are made to the loan terms and concessions are granted to the borrowers due to their financial difficulty. Generally, these loans would be restructured to provide the borrower additional time to execute its business plan. With respect to restructured loans, Capital Bank may grant concessions by (1) reduction of the stated interest rate for the remaining original life of the debt or (2) extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk. In situations where a TDR is unsuccessful and the borrower is unable to satisfy the terms of the restructured agreement, the loan would be placed on nonaccrual status and written down to the underlying collateral value.

Recent economic and market developments and the potential for continued economic disruption present considerable risks to CBF and it is difficult to determine the depth and duration of the economic and financial market problems and the many ways in which they may impact CBF's business in general. Any failure to manage such credit risks may materially adversely affect CBF's business and its consolidated results of operations and financial condition.

*A significant portion of Capital Bank's loan portfolio is secured by real estate, and events that negatively impact the real estate market could hurt its business.*

A significant portion of Capital Bank's loan portfolio is secured by real estate. As of December 31, 2011, approximately 86% of Capital Bank's loans had real estate as a primary or secondary component of collateral. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. A continued weakening of the real estate market in Capital Bank's primary market areas could continue to result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect on Capital Bank's profitability and asset quality. If Capital Bank is required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, its earnings and shareholders' equity could be adversely affected.

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Additionally, recent weakness in the secondary market for residential lending could have an adverse impact on Capital Bank's profitability. Significant ongoing disruptions in the secondary market for residential mortgage loans have limited the market for and liquidity of most mortgage loans other than conforming Fannie Mae and Freddie Mac loans. The effects of ongoing mortgage market challenges, combined with the ongoing correction in residential real estate market prices and reduced levels of home sales, could result in further price reductions in single family home values, adversely affecting the value of collateral securing mortgage loans held, any future mortgage loan originations and gains on sale of mortgage loans. Continued declines in real estate values and home sales volumes and financial stress on borrowers as a result of job losses or other factors could have further adverse effects on borrowers that result in higher delinquencies and charge-offs in future periods, which could adversely affect Capital Bank's financial position and results of operations.

***Capital Bank's construction and land development loans are based upon estimates of costs and the values of the complete projects.***

While Capital Bank intends to focus on originating loans other than non-owner occupied commercial real estate loans, its portfolio includes construction and land development loans (which we refer to as C&D loans) extended to builders and developers, primarily for the construction and/or development of properties. These loans have been extended on a presold and speculative basis and they include loans for both residential and commercial purposes.

In general, C&D lending involves additional risks because of the inherent difficulty in estimating a property's value both before and at completion of the project. Construction costs may exceed original estimates as a result of increased materials, labor or other costs. In addition, because of current uncertainties in the residential and commercial real estate markets, property values have become more difficult to determine than they have been historically. The repayment of construction and land acquisition and development loans is often dependent, in part, on the ability of the borrower to sell or lease the property. These loans also require ongoing monitoring. In addition, speculative construction loans to a residential builder are often associated with homes that are not presold and, thus, pose a greater potential risk than construction loans to individuals on their personal residences. Slowing housing sales have been a contributing factor to an increase in non-performing loans as well as an increase in delinquencies.

As of December 31, 2011, C&D loans totaled \$509.3 million (or 12% of Capital Bank's total loan portfolio), of which \$85.9 million was for construction and/or development of residential properties and \$423.3 million was for construction/development of commercial properties. As of December 31, 2011, non-performing C&D loans covered under FDIC loss share agreements totaled \$39.4 million and non-performing C&D loans not covered under FDIC loss share agreements totaled \$94.9 million.

***Capital Bank's non-owner occupied commercial real estate loans may be dependent on factors outside the control of its borrowers.***

While Capital Bank intends to focus on originating loans other than non-owner occupied commercial real estate loans, in the acquisitions it acquired non-owner occupied commercial real estate loans for individuals and businesses for various purposes, which are secured by commercial properties. These loans typically involve repayment dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service. This may be adversely affected by changes in the economy or local market conditions. Non-owner occupied commercial real estate loans expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans typically cannot be liquidated as easily as residential real estate. In such cases, Capital Bank may be compelled to modify the terms of the loan or engage in other potentially expensive work-out techniques. If Capital Bank forecloses on a non-owner occupied commercial real estate loan, the holding period for the collateral typically is longer than a 1-4 family residential property because there are fewer potential purchasers of the collateral. Additionally, non-owner occupied commercial real estate loans generally have relatively large balances to single borrowers or related groups of borrowers. Accordingly, charge-offs on non-owner occupied commercial real estate loans may be larger on a per loan basis than those incurred with Capital Bank's residential or consumer loan portfolios.

As of December 31, 2011, Capital Bank's non-owner occupied commercial real estate loans totaled \$903.9 million (or 21% of its total loan portfolio). As of December 31, 2011, non-performing non-owner occupied commercial real estate loans covered under FDIC loss share agreements totaled \$15.3 million and non-performing non-owner occupied commercial real estate loans not covered under FDIC loss share agreements totaled \$49.5 million.

***Repayment of Capital Bank's commercial business loans is dependent on the cash flows of borrowers, which may be unpredictable, and the collateral securing these loans may fluctuate in value.***

Capital Bank's business plan focuses on originating different types of commercial business loans. Capital Bank classifies the types of commercial loans offered as owner-occupied term real estate loans, business lines of credit and term equipment financing.



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Commercial business lending involves risks that are different from those associated with non-owner occupied commercial real estate lending. Capital Bank's commercial business loans are primarily underwritten based on the cash flow of the borrower and secondarily on the underlying collateral, including real estate. The borrower's cash flow may be unpredictable, and collateral securing these loans may fluctuate in value. Some of Capital Bank's commercial business loans are collateralized by equipment, inventory, accounts receivable or other business assets, and the liquidation of collateral in the event of default is often an insufficient source of repayment because accounts receivable may be uncollectible and inventories may be obsolete or of limited use.

As of December 31, 2011, Capital Bank's commercial business loans totaled \$1.4 billion (or 32% of its total loan portfolio). Of this amount, \$902.8 million was secured by owner-occupied real estate and \$465.8 million was secured by business assets. As of December 31, 2011, non-performing commercial business loans covered under FDIC loss share agreements totaled \$29.8 million and non-performing commercial business loans not covered under FDIC loss share agreements totaled \$67.7 million.

*Capital Bank's allowance for loan losses and fair value adjustments may prove to be insufficient to absorb losses for loans that it originates.*

Lending money is a substantial part of Capital Bank's business and each loan carries a certain risk that it will not be repaid in accordance with its terms or that any underlying collateral will not be sufficient to assure repayment. This risk is affected by, among other things:

cash flow of the borrower and/or the project being financed;

the changes and uncertainties as to the future value of the collateral, in the case of a collateralized loan;

the duration of the loan;

the discount on the loan at the time of acquisition;

the credit history of a particular borrower; and

changes in economic and industry conditions.

Non-performing loans covered under loss share agreements with the FDIC totaled \$124.2 million, and Non-performing loans not covered under loss share agreements with the FDIC totaled \$258.3 million as of December 31, 2011. Capital Bank maintains an allowance for loan losses with respect to loans it originates, which is a reserve established through a provision for loan losses charged to expense, which management believes is appropriate to provide for probable losses in Capital Bank's loan portfolio. The amount of this allowance is determined by Capital Bank's management team through periodic reviews. As of December 31, 2011, the allowance on loans covered by loss share agreements with the FDIC was \$11.8 million, and the allowance on loans not covered by loss share agreements with the FDIC was \$22.9 million. As of December 31, 2011, the ratio of Capital Bank's allowance for loan losses to non-performing loans covered by loss share agreements with the FDIC was 9.5% and the ratio of its allowance for loan losses to non-performing loans not covered by loss share agreements with the FDIC was 8.9%.

The application of the acquisition method of accounting to CBF's completed acquisitions impacted Capital Bank's allowance for loan losses. Under the acquisition method of accounting, all loans were recorded in financial statements at their fair value at the time of their acquisition and the related allowance for loan loss was eliminated because the fair value at the time was determined by the net present value of the expected cash flows taking into consideration estimated credit quality. Capital Bank may in the future determine that the estimates of fair value are too high, in which case Capital Bank would provide for additional loan losses associated with the acquired loans. As of December 31, 2011, the allowance for loan losses on purchased credit-impaired loan pools totaled \$26.3 million, of which \$11.8 million was related to loan pools covered by loss share agreements with the FDIC and \$14.5 million was related to loan pools not covered by loss share agreements with the FDIC.

The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires Capital Bank to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic

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conditions affecting borrowers, new information regarding existing loans that Capital Bank originates, identification of additional problem loans originated by Capital Bank and other factors, both within and outside of management's control, may require an increase in the allowance for loan losses. If current trends in the real estate markets continue, Capital Bank's management expects that it will continue to experience increased delinquencies and credit losses, particularly with respect to construction, land development and land loans. In addition, bank regulatory agencies periodically review Capital Bank's allowance for loan losses and may require an increase in the provision for probable loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses, Capital Bank will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, possibly, capital and may have a material adverse effect on Capital Bank's financial condition and results of operations.



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***Capital Bank continues to hold and acquire other real estate, which has led to increased operating expenses and vulnerability to additional declines in real property values.***

Capital Bank forecloses on and take title to the real estate serving as collateral for many of its loans as part of its business. Real estate owned by Capital Bank and not used in the ordinary course of its operations is referred to as other real estate owned or OREO property. At December 31, 2011, Capital Bank had \$168.8 million of OREO. Increased OREO balances have led to greater expenses as costs are incurred to manage and dispose of the properties. Capital Bank's management expects that its earnings will continue to be negatively affected by various expenses associated with OREO, including personnel costs, insurance and taxes, completion and repair costs, valuation adjustments and other expenses associated with property ownership, as well as by the funding costs associated with assets that are tied up in OREO. Any further decrease in real estate market prices may lead to additional OREO write-downs, with a corresponding expense in Capital Bank's statement of operations. Capital Bank's management evaluates OREO properties periodically and writes down the carrying value of the properties if the results of such evaluations require it. The expenses associated with OREO and any further property write-downs could have a material adverse effect on Capital Bank's financial condition and results of operations.

***Capital Bank is subject to environmental liability risk associated with lending activities.***

A significant portion of Capital Bank's loan portfolio is secured by real property. During the ordinary course of business, Capital Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, Capital Bank may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require Capital Bank to incur substantial expenses to address unknown liabilities and may materially reduce the affected property's value or limit the Bank's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase Capital Bank's exposure to environmental liability. Although Capital Bank has policies and procedures to perform an environmental review before initiating any foreclosure action on nonresidential real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on Capital Bank's financial condition and results of operations.

***Delinquencies and defaults in residential mortgages have increased, creating a backlog in courts and an increase in industry scrutiny by regulators, as well as resulting in proposed new laws and regulations governing foreclosures. Such laws and regulations might restrict or delay Capital Bank's ability to foreclose and collect payments for single family residential loans under the loss sharing agreements.***

Recent laws delay the initiation or completion of foreclosure proceedings on specified types of residential mortgage loans (some for a limited period of time), or otherwise limit the ability of residential loan servicers to take actions that may be essential to preserve the value of the mortgage loans. Any such limitations are likely to cause delayed or reduced collections from mortgagors and generally increased servicing costs. As a servicer of mortgage loans, any restriction on Capital Bank's ability to foreclose on a loan, any requirement that the Bank forego a portion of the amount otherwise due on a loan or any requirement that the Bank modify any original loan terms will in some instances require Capital Bank to advance principal, interest, tax and insurance payments, which may negatively impact its business, financial condition, liquidity and results of operations.

In addition, for the single family residential loans covered by the loss sharing agreements, Capital Bank cannot collect loss share payments until it liquidates the properties securing those loans. These loss share payments could be delayed by an extended foreclosure process, including delays resulting from a court backlog, local or national foreclosure moratoriums or other delays, and these delays could have a material adverse effect on Capital Bank's results of operations.

***Like other financial services institutions, Capital Bank's asset and liability structures are monetary in nature. Such structures are affected by a variety of factors, including changes in interest rates, which can impact the value of financial instruments held by the Bank.***

Like other financial services institutions, Capital Bank has asset and liability structures that are essentially monetary in nature and are directly affected by many factors, including domestic and international economic and political conditions, broad trends in business and finance, legislation and regulation affecting the national and international business and financial communities, monetary and fiscal policies, inflation, currency values, market conditions, the availability and cost of short-term or long-term funding and capital, the credit capacity or perceived creditworthiness of customers and counterparties and the level and volatility of trading markets. Such factors can impact customers and counterparties of a financial services institution and may impact the value of financial instruments held by a financial services institution.



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Capital Bank's earnings and cash flows largely depend upon the level of its net interest income, which is the difference between the interest income it earns on loans, investments and other interest earning assets, and the interest it pays on interest bearing liabilities, such as deposits and borrowings. Because different types of assets and liabilities may react differently and at different times to market interest rate changes, changes in interest rates can increase or decrease Capital Bank's net interest income. When interest-bearing liabilities mature or reprice more quickly than interest earning assets in a period, an increase in interest rates could reduce net interest income. Similarly, when interest earning assets mature or reprice more quickly, and because the magnitude of repricing of interest earning assets is often greater than interest bearing liabilities, falling interest rates could reduce net interest income.

Additionally, an increase in interest rates may, among other things, reduce the demand for loans and Capital Bank's ability to originate loans and decrease loan repayment rates, while a decrease in the general level of interest rates may adversely affect the fair value of the Bank's financial assets and liabilities and its ability to realize gains on the sale of assets. A decrease in the general level of interest rates may affect Capital Bank through, among other things, increased prepayments on its loan and mortgage-backed securities portfolios and increased competition for deposits.

Accordingly, changes in the level of market interest rates affect Capital Bank's net yield on interest earning assets, loan origination volume, loan and mortgage-backed securities portfolios and its overall results. Changes in interest rates may also have a significant impact on any future mortgage loan origination revenues. Historically, there has been an inverse correlation between the demand for mortgage loans and interest rates. Mortgage origination volume and revenues usually decline during periods of rising or high interest rates and increase during periods of declining or low interest rates. Changes in interest rates also have a significant impact on the carrying value of a significant percentage of the assets on Capital Bank's balance sheet. Interest rates are highly sensitive to many factors beyond the Bank's management's control, including general economic conditions and policies of various governmental and regulatory agencies, particularly the Board of Governors of the Federal Reserve System (which we refer to as the Federal Reserve). Capital Bank's management cannot predict the nature and timing of the Federal Reserve's interest rate policies or other changes in monetary policies and economic conditions, which could negatively impact the Bank's financial performance.

Capital Bank has benefited in recent periods from a favorable interest rate environment, but management believes that this environment cannot be sustained indefinitely and interest rates would be expected to rise as the economy recovers. A strengthening U.S. economy would be expected to cause the Board of Governors of the Federal Reserve to increase short-term interest rates, which would increase Capital Bank's borrowing costs.

***The fair value of Capital Bank's investment securities can fluctuate due to market conditions out of management's control.***

As of December 31, 2011, approximately 94% of Capital Bank's investment securities portfolio was comprised of U.S. government agency and sponsored enterprises obligations, U.S. government agency and sponsored enterprises mortgage-backed securities and securities of municipalities. As of December 31, 2011, the fair value of Capital Bank's investment securities portfolio was approximately \$827.4 million. Factors beyond Capital Bank's control can significantly influence the fair value of securities in its portfolio and can cause potential adverse changes to the fair value of these securities. These factors include, but are not limited to, rating agency downgrades of the securities, defaults by the issuer or with respect to the underlying securities, changes in market interest rates and continued instability in the credit markets. In addition, Capital Bank has historically taken a conservative investment posture, concentrating on government issuances of short duration. In the future, Capital Bank may seek to increase yields through more aggressive investment strategies, which may include a greater percentage of corporate issuances and structured credit products. Any of these mentioned factors, among others, could cause other-than-temporary impairments in future periods and result in a realized loss, which could have a material adverse effect on Capital Bank's business. The process for determining whether impairment is other-than-temporary usually requires complex, subjective judgments about the future financial performance of the issuer and any collateral underlying the security in order to assess the probability of receiving all contractual principal and interest payments on the security. Because of changing economic and market conditions affecting issuers and the performance of the underlying collateral, Capital Bank may recognize realized and/or unrealized losses in future periods, which could have an adverse effect on its financial condition and results of operations.

***Capital Bank has a significant deferred tax asset that may not be fully realized in the future.***

Capital Bank's net deferred tax asset totaled \$164.2 million as of December 31, 2011. The ultimate realization of a deferred tax asset is dependent upon the generation of future taxable income during the periods prior to the expiration of the related net operating losses. If Capital Bank's estimates and assumptions about future taxable income are not accurate, the value of its deferred tax asset may not be recoverable and may result in a valuation allowance that would impact the Bank's earnings.



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***Recent market disruptions have caused increased liquidity risks and, if Capital Bank is unable to maintain sufficient liquidity, it may not be able to meet the cash flow requirements of its depositors and borrowers.***

The recent disruption and illiquidity in the credit markets have generally made potential funding sources more difficult to access, less reliable and more expensive. Capital Bank's liquidity is generally used to make loans and to repay deposit liabilities as they become due or are demanded by customers, and further deterioration in the credit markets or a prolonged period without improvement of market liquidity could present significant challenges in the management of Capital Bank's liquidity and could adversely affect its business, results of operations and prospects. For example, if as a result of a sudden decline in depositor confidence resulting from negative market conditions, a substantial number of bank customers tried to withdraw their bank deposits simultaneously, Capital Bank's reserves may not be able to cover the withdrawals.

Furthermore, an inability to increase Capital Bank's deposit base at all or at attractive rates would impede its ability to fund the Bank's continued growth, which could have an adverse effect on the Bank's business, results of operations and financial condition. Collateralized borrowings such as advances from the FHLB are an important potential source of liquidity. Capital Bank's borrowing capacity is generally dependent on the value of the collateral pledged to the FHLB. An adverse regulatory change could reduce Capital Bank's borrowing capacity or eliminate certain types of collateral and could otherwise modify or even eliminate the Bank's access to FHLB advances, Federal Fund line borrowings and discount window advances. Liquidity may also be adversely impacted by bank supervisory and regulatory authorities mandating changes in the composition of Capital Bank's balance sheet to asset classes that are less liquid. Any such change or termination may have an adverse effect on Capital Bank's liquidity.

Capital Bank's access to other funding sources could be impaired by factors that are not specific to the Bank, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of recent turmoil faced by banking organizations and the unstable credit markets. Capital Bank may need to incur additional debt in the future to achieve its business objectives, in connection with future acquisitions or for other reasons. Any borrowings, if sought, may not be available to Capital Bank or, if available, may not be on favorable terms. Without sufficient liquidity, Capital Bank may not be able to meet the cash flow requirements of its depositors and borrowers, which could have a material adverse effect on the Bank's financial condition and results of operations.

***Capital Bank may not be able to retain or develop a strong core deposit base or other low-cost funding sources.***

Capital Bank expects to depend on checking, savings and money market deposit account balances and other forms of customer deposits as its primary source of funding for the Bank's lending activities. Capital Bank's future growth will largely depend on its ability to retain and grow a strong deposit base. Because 43% of Capital Bank's deposits as of December 31, 2011 were time deposits, it may prove harder to maintain and grow the Bank's deposit base than would otherwise be the case. Capital Bank is also working to transition certain of its customers to lower cost traditional banking services as higher cost funding sources, such as high interest certificates of deposit, mature. There may be competitive pressures to pay higher interest rates on deposits, which could increase funding costs and compress net interest margins. Customers may not transition to lower yielding savings or investment products or continue their business with Capital Bank, which could adversely affect its operations. In addition, with recent concerns about bank failures, customers have become concerned about the extent to which their deposits are insured by the FDIC, particularly customers that may maintain deposits in excess of insured limits. Customers may withdraw deposits in an effort to ensure that the amount that they have on deposit with Capital Bank is fully insured and may place them in other institutions or make investments that are perceived as being more secure. Further, even if Capital Bank is able to grow and maintain its deposit base, the account and deposit balances can decrease when customers perceive alternative investments, such as the stock market, as providing a better risk/return tradeoff. If customers move money out of bank deposits and into other investments (or similar products at other institutions that may provide a higher rate of return), Capital Bank could lose a relatively low cost source of funds, increasing its funding costs and reducing the Bank's net interest income and net income. Additionally, any such loss of funds could result in lower loan originations, which could materially negatively impact Capital Bank's growth strategy and results of operations.

***Capital Bank operates in a highly competitive industry and faces significant competition from other financial institutions and financial services providers, which may decrease its growth or profits.***

Consumer and commercial banking is highly competitive. Capital Bank's market contains not only a large number of community and regional banks, but also a significant presence of the country's largest commercial banks. Capital Bank competes with other state and national financial institutions as well as savings and loan associations, savings banks and credit unions for deposits and loans. In addition, Capital Bank competes with financial intermediaries, such as consumer finance companies, mortgage banking companies, insurance companies, securities firms, mutual funds and several government agencies as well as major retailers, all actively engaged in providing various types of loans and other financial services. Some of these competitors may have a long history of successful operations in Capital Bank's markets, greater ties to local businesses and more expansive banking relationships, as well as better established depositor bases. Competitors with greater resources may possess an advantage by being capable of maintaining numerous banking locations in more convenient sites, operating more ATMs and conducting extensive promotional and advertising campaigns or operating a more developed Internet platform.



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The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Increased competition among financial services companies due to the recent consolidation of certain competing financial institutions may adversely affect Capital Bank's ability to market its products and services. Also, technology has lowered barriers to entry and made it possible for banks to compete in Capital Bank's market without a retail footprint by offering competitive rates, as well as non-banks to offer products and services traditionally provided by banks. Many of Capital Bank's competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may offer a broader range of products and services as well as better pricing for certain products and services than Capital Bank can.

Capital Bank's ability to compete successfully depends on a number of factors, including:

the ability to develop, maintain and build upon long-term customer relationships based on quality service and high ethical standards;

the ability to attract and retain qualified employees to operate the Bank's business effectively;

the ability to expand the Bank's market position;

the scope, relevance and pricing of products and services offered to meet customer needs and demands;

the rate at which the Bank introduces new products and services relative to its competitors;

customer satisfaction with the Bank's level of service; and

industry and general economic trends.

Failure to perform in any of these areas could significantly weaken Capital Bank's competitive position, which could adversely affect its growth and profitability, which, in turn, could harm the Bank's business, financial condition and results of operations.

### ***Capital Bank may be adversely affected by the soundness of other financial institutions***

Capital Bank's ability to engage in routine funding and other transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. Defaults by, or even rumors or questions about, one or more financial institutions, or the financial services industry generally, may lead to market-wide liquidity problems and losses of depositor, creditor and counterparty confidence and could lead to losses or defaults by us or by other institutions.

### ***Capital Bank is subject to losses due to the errors or fraudulent behavior of employees or third parties.***

Capital Bank is exposed to many types of operational risk, including the risk of fraud by employees and outsiders, clerical recordkeeping errors and transactional errors. Capital Bank's business is dependent on its employees as well as third-party service providers to process a large number of increasingly complex transactions. Capital Bank could be materially adversely affected if one of its employees causes a significant operational breakdown or failure, either as a result of human error or where an individual purposefully sabotages or fraudulently manipulates the Bank's operations or systems. When Capital Bank originates loans, it relies upon information supplied by loan applicants and third parties, including the information contained in the loan application, property appraisal and title information, if applicable, and employment and income documentation provided by third parties. If any of this information is misrepresented and such misrepresentation is not detected prior to loan funding, Capital

Bank generally bears the risk of loss associated with the misrepresentation. Any of these occurrences could result in a diminished ability of Capital Bank to operate its business, potential liability to customers, reputational damage and regulatory intervention, which could negatively impact the Bank's business, financial condition and results of operations.

***Capital Bank is dependent on its information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have an adverse effect on the Bank's financial condition and results of operations.***

Capital Bank's business is highly dependent on the successful and uninterrupted functioning of its information technology and telecommunications systems and third-party servicers. Capital Bank outsources many of its major systems, such



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as data processing, loan servicing and deposit processing systems. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt the Bank's operations. Because Capital Bank's information technology and telecommunications systems interface with and depend on third-party systems, the Bank could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of Capital Bank's ability to process new and renewal loans, gather deposits and provide customer service, compromise the Bank's ability to operate effectively, damage its reputation, result in a loss of customer business and/or subject the Bank to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on the Bank's financial condition and results of operations.

In addition, Capital Bank provides its customers the ability to bank remotely, including online over the Internet. The secure transmission of confidential information is a critical element of remote banking. Capital Bank's network could be vulnerable to unauthorized access, computer viruses, phishing schemes, spam attacks, human error, natural disasters, power loss and other security breaches. Capital Bank may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that Capital Bank's activities or the activities of its customers involve the storage and transmission of confidential information, security breaches and viruses could expose the Bank to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in Capital Bank's systems and could adversely affect its reputation, results of operations and ability to attract and maintain customers and businesses. In addition, a security breach could also subject Capital Bank to additional regulatory scrutiny, expose the Bank to civil litigation and possible financial liability and cause reputational damage.

***Hurricanes or other adverse weather events would negatively affect Capital Bank's local economies or disrupt its operations, which would have an adverse effect on the Bank's business or results of operations.***

Capital Bank's market areas in the southeastern region of the United States are susceptible to natural disasters, such as hurricanes, tornadoes, tropical storms, other severe weather events and related flooding and wind damage, and manmade disasters, such as the 2010 oil spill in the Gulf of Mexico. Capital Bank's market areas in Tennessee are susceptible to natural disasters, such as tornadoes and floods. These natural disasters could negatively impact regional economic conditions, cause a decline in the value or destruction of mortgaged properties and an increase in the risk of delinquencies, foreclosures or loss on loans originated by Capital Bank, damage its banking facilities and offices and negatively impact the Bank's growth strategy. Such weather events can disrupt operations, result in damage to properties and negatively affect the local economies in the markets where Capital Bank operates. The Bank's management cannot predict whether or to what extent damage that may be caused by future hurricanes or tornadoes will affect Capital Bank's operations or the economies in its current or future market areas, but such weather events could negatively impact economic conditions in these regions and result in a decline in local loan demand and loan originations, a decline in the value or destruction of properties securing Capital Bank's loans and an increase in delinquencies, foreclosures or loan losses. Capital Bank's business or results of operations may be adversely affected by these and other negative effects of natural or manmade disasters.

### **Risks Relating to Capital Bank's Growth Strategy**

***Capital Bank may not be able to effectively manage its growth.***

Capital Bank's future operating results depend to a large extent on its ability to successfully manage its rapid growth. Capital Bank's rapid growth has placed, and it may continue to place, significant demands on its operations and management. Whether through additional acquisitions or organic growth, Capital Bank's current plan to expand its business is dependent upon:

the ability of its officers and other key employees to continue to implement and improve its operational, credit, financial, management and other internal risk controls and processes and its reporting systems and procedures in order to manage a growing number of client relationships;

to scale its technology platform;

to integrate its acquisitions and develop consistent policies throughout the various businesses; and

to manage a growing number of client relationships.

Capital Bank may not successfully implement improvements to, or integrate, its management information and control systems, procedures and processes in an efficient or timely manner and may discover deficiencies in existing systems and controls. In particular, Capital Bank's controls and procedures must be able to accommodate an increase in expected

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loan volume and the infrastructure that comes with new branches and banks. Thus, Capital Bank's growth strategy may divert management from its existing businesses and may require the Bank to incur additional expenditures to expand its administrative and operational infrastructure and, if Capital Bank is unable to effectively manage and grow its banking franchise, its business and the Bank's consolidated results of operations and financial condition could be materially and adversely impacted. In addition, if Capital Bank is unable to manage future expansion in its operations, the Bank may experience compliance and operational problems, have to slow the pace of growth, or have to incur additional expenditures beyond current projections to support such growth, any one of which could adversely affect Capital Bank's business.

***Many of Capital Bank's new activities and expansion plans require regulatory approvals, and failure to obtain them may restrict its growth.***

Capital Bank intends to complement and expand its business by pursuing strategic acquisitions of banks and other financial institutions. Generally, any acquisition of target financial institutions or assets by CBF or Capital Bank will require approval by, and cooperation from, a number of governmental regulatory agencies, possibly including the Federal Reserve, the OCC and the FDIC, as well as state banking regulators. In acting on such applications of approval, federal banking regulators consider, among other factors:

the effect of the acquisition on competition;

the financial condition and future prospects of the applicant and the banks involved;

the managerial resources of the applicant and the banks involved;

the convenience and needs of the community, including the record of performance under the Community Reinvestment Act (which we refer to as the "CRA"); and

the effectiveness of the applicant in combating money laundering activities.

Such regulators could deny an application based on the above criteria or other considerations or the regulatory approvals may not be granted on terms that are acceptable to CBF or Capital Bank. For example, Capital Bank could be required to sell branches as a condition to receiving regulatory approvals, and such a condition may not be acceptable to CBF or Capital Bank or may reduce the benefit of any acquisition.

***The success of future transactions will depend on CBF's ability to successfully identify and consummate transactions with target financial institutions that meet its investment criteria. Because of the significant competition for acquisition opportunities and the limited number of potential targets, CBF may not be able to successfully consummate acquisitions necessary to grow its business.***

The success of future transactions will depend on CBF's ability to successfully identify and consummate transactions with target financial institutions that meet its investment criteria. There are significant risks associated with CBF's ability to identify and successfully consummate transactions with target financial institutions. There are a limited number of acquisition opportunities, and CBF expects to encounter intense competition from other banking organizations competing for acquisitions and also from other investment funds and entities looking to acquire financial institutions. Many of these entities are well established and have extensive experience in identifying and effecting acquisitions directly or through affiliates. Many of these competitors possess ongoing banking operations with greater technical, human and other resources than CBF and Capital Bank do, and CBF's financial resources will be relatively limited when contrasted with those of many of these competitors. These organizations may be able to achieve greater cost savings through consolidating operations than CBF could. CBF's ability to compete in acquiring certain sizable target institutions will be limited by its available financial resources. These inherent competitive limitations give others an advantage in pursuing the acquisition of certain target financial institutions. In addition, increased competition may drive up the prices for the types of acquisitions CBF intends to target, which would make the identification and successful consummation of acquisition opportunities more difficult. Competitors may be willing to pay more for target financial institutions than CBF believes are justified, which could result in CBF having to pay more for target financial institutions than it prefers or to forego target financial institutions. As a result of the foregoing, CBF may be unable to successfully identify and consummate future transactions to grow its business on commercially attractive terms, or at all.

***Because the institutions CBF intends to acquire may have distressed assets, CBF may not be able to realize the value it predicts from these assets or make sufficient provision for future losses in the value of, or accurately estimate the future write-downs taken in respect of, these***

*assets.*

Delinquencies and losses in the loan portfolios and other assets of financial institutions that CBF acquires may exceed its initial forecasts developed during the due diligence investigation prior to acquiring those institutions. Even if CBF conducts extensive due diligence on an entity it decides to acquire, this diligence may not reveal all material issues that may affect a particular entity. The diligence process in FDIC-assisted transactions is also expedited due to the short acquisition timeline that

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is typical for these depository institutions. If, during the diligence process, CBF fails to identify issues specific to an entity or the environment in which the entity operates, CBF may be forced to later write down or write off assets, restructure its operations, or incur impairment or other charges that could result in other reporting losses. Any of these events could adversely affect the financial condition, liquidity, capital position and value of institutions CBF acquires and of CBF as a whole. If any of the foregoing adverse events occur with respect to one subsidiary, they may adversely affect other of CBF's subsidiaries or the CBF as a whole. Current economic conditions have created an uncertain environment with respect to asset valuations and there is no certainty that CBF will be able to sell assets of target institutions if it determines it would be in its best interests to do so. The institutions CBF will target may have substantial amounts of asset classes for which there is currently limited or no marketability.

***The success of future transactions will depend on CBF's ability to successfully combine the target financial institution's business with CBF's existing banking business and, if CBF experiences difficulties with the integration process, the anticipated benefits of the acquisition may not be realized fully or at all or may take longer to realize than expected.***

The success of future transactions will depend, in part, on CBF's ability to successfully combine the target financial institution's business with its existing banking business. As with any acquisition involving financial institutions, there may be business disruptions that result in the loss of customers or cause customers to remove their accounts and move their business to competing banking institutions. It is possible that the integration process could result in additional expenses in connection with the integration processes and the disruption of ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect Capital Bank's ability to maintain relationships with clients, customers, depositors and employees or to achieve the anticipated benefits of the acquisition. Integration efforts, including integration of the target financial institution's systems into Capital Bank's systems may divert the Bank's management's attention and resources, and CBF may be unable to develop, or experience prolonged delays in the development of, the systems necessary to operate its acquired banks, such as a financial reporting platform or a human resources reporting platform call center. If CBF experiences difficulties with the integration process, the anticipated benefits of any future transaction may not be realized fully or at all or may take longer to realize than expected. Additionally, CBF and Capital Bank may be unable to recognize synergies, operating efficiencies and/or expected benefits within expected timeframes within expected cost projections, or at all. CBF may also not be able to preserve the goodwill of the acquired financial institution.

***Projected operating results for entities to be acquired by CBF may be inaccurate and may vary significantly from actual results.***

CBF will generally establish the pricing of transactions and the capital structure of entities to be acquired on the basis of financial projections for such entities. In general, projected operating results will be based primarily on management judgments. In all cases, projections are only estimates of future results that are based upon assumptions made at the time that the projections are developed and the projected results may vary significantly from actual results. General economic, political and market conditions, which are not predictable, can have a material adverse impact on the reliability of such projections. In the event that the projections made in connection with CBF's acquisitions, or future projections with respect to new acquisitions, are not accurate, such inaccuracies could materially and adversely affect Capital Bank's business and CBF's consolidated results of operations and financial condition.

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*Changes in accounting standards may affect how we report our financial condition and results of operations.*

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time, the Financial Accounting Standards Board (which we refer to as the FASB) or other regulatory authorities change the financial accounting and reporting standards that govern the preparation of financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in us restating prior period financial statements.

### **Risks Relating to the Regulation of Capital Bank's Industry**

*Capital Bank operates in a highly regulated industry and the laws and regulations that govern its operations, corporate governance, executive compensation and financial accounting, or reporting, including changes in them or Capital Bank's failure to comply with them, may adversely affect us.*

Capital Bank is subject to extensive regulation and supervision that govern almost all aspects of its operations. Intended to protect customers, depositors, consumers, deposit insurance funds and the stability of the U.S. financial system, these laws and regulations, among other matters, prescribe minimum capital requirements, impose limitations on the Company and Capital Bank's business activities, limit the dividend or distributions that Capital Bank or the Company can pay, restrict the ability of institutions to guarantee Capital Bank's debt and impose certain specific accounting requirements that may be more restrictive and may result in greater or earlier charges to earnings or reductions in the Bank's capital than generally accepted accounting principles. Compliance with laws and regulations can be difficult and costly and changes to laws and regulations often impose additional compliance costs. Capital Bank is currently facing increased regulation and supervision of the industry as a result of the financial crisis in the banking and financial markets. Such additional regulation and supervision may increase Capital Bank's costs and limit its ability to pursue business opportunities. Further, the Company, CBF or Capital Bank's failure to comply with these laws and regulations, even if the failure was inadvertent or reflects a difference in interpretation, could subject the Bank to restrictions on its business activities, fines and other penalties, any of which could adversely affect its results of operations, capital base and the price of CBF's or the Company's securities. Further, any new laws, rules and regulations could make compliance more difficult or expensive or otherwise adversely affect Capital Bank's business and financial condition.

*Capital Bank is periodically subject to examination and scrutiny by a number of banking agencies and, depending upon the findings and determinations of these agencies, the Bank may be required to make adjustments to its business that could adversely affect it.*

Federal and state banking agencies periodically conduct examinations of Capital Bank's business, including compliance with applicable laws and regulations. If, as a result of an examination, a federal banking agency were to determine that the financial condition, capital resources, asset quality, asset concentration, earnings prospects, management, liquidity sensitivity to market risk or other aspects of any of Capital Bank's operations has become unsatisfactory, or that the Bank or its management is in violation of any law or regulation, it could take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin unsafe or unsound practices, to require affirmative actions to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in Capital Bank's capital, to restrict its growth, to change the asset composition of its portfolio or balance sheet, to assess civil monetary penalties against its officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate its deposit insurance. If Capital Bank becomes subject to such regulatory actions, its business, results of operations and reputation may be negatively impacted.

*The enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 may have a material effect on Capital Bank's operations.*

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (which we refer to as the Dodd-Frank Act), which imposes significant regulatory and compliance changes. The key effects of the Dodd-Frank Act on Capital Bank's business are:

changes to regulatory capital requirements;

exclusion of hybrid securities, including trust preferred securities, issued on or after May 19, 2010 from Tier 1 capital;

creation of new government regulatory agencies (such as the Financial Stability Oversight Council, which will oversee systemic risk, and the Consumer Financial Protection Bureau, which will develop and enforce rules for bank and non-bank providers of consumer financial products);

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potential limitations on federal preemption;

changes to deposit insurance assessments;

regulation of debit interchange fees the Bank earns;

changes in retail banking regulations, including potential limitations on certain fees the Bank may charge; and

changes in regulation of consumer mortgage loan origination and risk retention.

In addition, the Dodd-Frank Act restricts the ability of banks to engage in certain proprietary trading or to sponsor or invest in private equity or hedge funds. The Dodd-Frank Act also contains provisions designed to limit the ability of insured depository institutions, their holding companies and their affiliates to conduct certain swaps and derivatives activities and to take certain principal positions in financial instruments.

Some provisions of the Dodd-Frank Act became effective immediately upon its enactment. Many provisions, however, will require regulations to be promulgated by various federal agencies in order to be implemented, some of which have been proposed by the applicable federal agencies. The provisions of the Dodd-Frank Act may have unintended effects, which will not be clear until implementation. The changes resulting from the Dodd-Frank Act may impact the profitability of Capital Bank's business activities, require changes to certain of its business practices, impose upon the Bank more stringent capital, liquidity and leverage requirements or otherwise adversely affect Capital Bank's business. These changes may also require Capital Bank to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the new requirements may negatively impact Capital Bank's results of operations and financial condition. While management cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on Capital Bank or the Company, these changes could be materially adverse to the Company, Capital Bank and CBF.

***The short-term and long-term impact of the new regulatory capital standards and the forthcoming new capital rules is uncertain.***

On September 12, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, announced an agreement to a strengthened set of capital requirements for internationally active banking organizations in the United States and around the world, known as Basel III. Basel III increases the requirements for minimum common equity, minimum Tier 1 capital and minimum total capital, to be phased in over time until fully phased in by January 1, 2019.

Various provisions of the Dodd-Frank Act increase the capital requirements of bank holding companies, such as the Company, and non-bank financial companies that are supervised by the Federal Reserve. The leverage and risk-based capital ratios of these entities may not be lower than the leverage and risk-based capital ratios for insured depository institutions. In particular, bank holding companies, many of which have long relied on trust preferred securities as a component of their regulatory capital, will no longer be permitted to count trust preferred securities toward their Tier 1 capital. While the Basel III changes and other regulatory capital requirements will likely result in generally higher regulatory capital standards, it is difficult at this time to predict how any new standards will ultimately be applied to the Company, CBF and Capital Bank.

***The FDIC's restoration plan and the related increased assessment rate could adversely affect Capital Bank's earnings.***

The FDIC insures deposits at FDIC-insured depository institutions, such as Capital Bank, up to applicable limits. The amount of a particular institution's deposit insurance assessment is based on that institution's risk classification under an FDIC risk-based assessment system. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to its regulators. Market developments have significantly depleted the deposit insurance fund of the FDIC (which we refer to as the DIF) and reduced the ratio of reserves to insured deposits. As a result of recent economic conditions and the enactment of the Dodd-Frank Act, the FDIC has increased the deposit insurance assessment rates and thus raised deposit premiums for insured depository institutions. If these increases are insufficient for the DIF to meet its funding requirements, there may need to be further special assessments or increases in deposit insurance premiums. Capital Bank is generally unable to control the amount of premiums that it is required to pay for FDIC insurance. If there are additional bank or financial institution failures, Capital Bank may be required to pay even higher FDIC premiums than the recently increased levels. Any future additional assessments, increases or required prepayments in FDIC insurance premiums may materially adversely affect results of operations, including by reducing Capital Bank's profitability or limiting its ability to pursue certain business opportunities.





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***Capital Bank is subject to federal and state and fair lending laws, and failure to comply with these laws could lead to material penalties.***

Federal and state fair lending laws and regulations, such as the Equal Credit Opportunity Act and the Fair Housing Act, impose nondiscriminatory lending requirements on financial institutions. The Department of Justice, Consumer Financial Protection Bureau and other federal and state agencies are responsible for enforcing these laws and regulations. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. A successful challenge to Capital Bank's performance under the fair lending laws and regulations could adversely impact the Bank's rating under the Community Reinvestment Act and result in a wide variety of sanctions, including the required payment of damages and civil money penalties, injunctive relief, imposition of restrictions on merger and acquisition activity and restrictions on expansion activity, which could negatively impact Capital Bank's reputation, business, financial condition and results of operations.

***Capital Bank faces a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.***

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (which we refer to as the PATRIOT Act) and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. There is also increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control (which we refer to as OFAC). If Capital Bank's policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that CBF has already acquired or may acquire in the future are deficient, Capital Bank would be subject to liability, including fines and regulatory actions such as restrictions on its ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of its business plan, including its acquisition plans, which would negatively impact its business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for Capital Bank.

***Federal, state and local consumer lending laws may restrict Capital Bank's ability to originate certain mortgage loans or increase the Bank's risk of liability with respect to such loans and could increase its cost of doing business.***

Federal, state and local laws have been adopted that are intended to eliminate certain lending practices considered predatory. These laws prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. It is Capital Bank's policy not to make predatory loans, but these laws create the potential for liability with respect to the Bank's lending and loan investment activities. They increase Capital Bank's cost of doing business and, ultimately, may prevent the Bank from making certain loans and cause it to reduce the average percentage rate or the points and fees on loans that it does make.

***The Federal Reserve may require the Company or CBF and its other subsidiaries to commit capital resources to support Capital Bank.***

The Federal Reserve, which examines the Company and CBF, requires a bank holding company to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to support such subsidiary bank. Under the source of strength doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. In addition, the Dodd-Frank Act directs the federal bank regulators to require that all companies that directly or indirectly control an insured depository institution serve as a source of strength for the institution. Under these requirements, in the future, the Company or CBF could be required to provide financial assistance to Capital Bank if it experiences financial distress.

A capital injection may be required at times when the Company or CBF do not have the resources to provide it, and therefore the Company or CBF may be required to borrow the funds. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the holding company's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by the holding company in order to make the required capital injection becomes more difficult and expensive and will adversely impact the holding company's cash flows, financial condition, results of operations and prospects.



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***Stockholders may be deemed to be acting in concert or otherwise in control of Capital Bank, which could impose prior approval requirements and result in adverse regulatory consequences for such holders.***

The Company and CBF are bank holding companies regulated by the Federal Reserve. Accordingly, acquisition of control of CBF or the Company (or a bank subsidiary) requires prior regulatory notice or approval. With certain limited exceptions, federal regulations prohibit potential investors from, directly or indirectly, acquiring ownership or control of, or the power to vote, more than 10% (more than 5% if the acquirer is a bank holding company) of any class of our voting securities, or obtaining the ability to control in any manner the election of a majority of directors or otherwise exercising a controlling influence over CBF or Capital Bank's management or policies, without prior notice or application to, and approval of, the Federal Reserve under the Change in Bank Control Act or the Bank Holding Company Act of 1956, as amended (which we refer to as the "BHCA"). Any bank holding company or foreign bank with a U.S. presence also is required to obtain the approval of the Federal Reserve under the BHCA to acquire or retain more than 5% of the Company or CBF's outstanding voting securities.

In addition to regulatory approvals, any stockholder deemed to control the Company or CBF for purposes of the BHCA would become subject to investment and activity restrictions and ongoing regulation and supervision. Any entity owning 25% or more of any class of the Company or CBF's voting securities, or a lesser percentage if such holder or group otherwise exercises a controlling influence over the Company or CBF, may be subject to regulation as a bank holding company in accordance with the BHCA. In addition, such a holder may be required to divest 5% or more of the voting securities of investments that may be deemed incompatible with bank holding company status, such as an investment in a company engaged in non-financial activities.

Regulatory determination of control of a depository institution or holding company is based on all of the relevant facts and circumstances. In certain instances, stockholders may be determined to be acting in concert and their shares aggregated for purposes of determining control for purposes of the Change in Bank Control Act. Acting in concert generally means knowing participation in a joint activity or parallel action towards the common goal of acquiring control of a bank or a parent company, whether or not pursuant to an express agreement. How this definition is applied in individual circumstances can vary among the various federal bank regulatory agencies and cannot always be predicted with certainty. Many factors can lead to a finding of acting in concert, including whether:

stockholders are commonly controlled or managed;

stockholders are parties to an oral or written agreement or understanding regarding the acquisition, voting or transfer of control of voting securities of a bank or bank holding company;

the holders each own stock in a bank and are also management officials, controlling stockholders, partners or trustees of another company; or

both a holder and a controlling stockholder, partner, trustee or management official of the holder own equity in the bank or bank holding company.

The Company's or CBF's common stock owned by holders determined by a bank regulatory agency to be acting in concert would be aggregated for purposes of determining whether those holders have control of a bank or bank holding company for Change in Bank Control Act purposes. Because the control regulations under the Change in Bank Control Act and the BHCA are complex, potential investors should seek advice from qualified banking counsel before making an investment in the Company's common stock.

### **Risks Related to CBF's Common Stock Proposed to be Issued in the merger**

***The market price of CBF's Class A common stock could decline due to the large number of outstanding shares of its common stock eligible for future sale.***

Sales of substantial amounts of CBF's Class A common stock in the public market following the initial public offering or in future offerings, or the perception that these sales could occur, could cause the market price of CBF's Class A common stock to decline. These sales could also make it more difficult for CBF to sell equity or equity-related securities in the future, at a time and place that CBF deems appropriate.

## Edgar Filing: GREEN BANKSHARES, INC. - Form 10-K

In addition, CBF intends to file a registration statement on Form S-8 under the Securities Act to register additional shares of Class A common stock for issuance under CBF's 2010 Equity Incentive Plan. CBF may issue all of these shares without any action or approval by CBF's stockholders and these shares once issued (including upon exercise of outstanding options) will be

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available for sale into the public market subject to the restrictions described above, if applicable to the holder. Any shares issued in connection with acquisitions, the exercise of stock options or otherwise would dilute the percentage ownership held by investors who acquire CBF's shares in the merger.

***If shares of CBF's Class B non-voting common stock are converted into shares of Class A common stock, your voting power subsequent to the merger will be diluted.***

Generally, holders of CBF's Class B non-voting common stock have no voting power and have no right to participate in any meeting of stockholders or to have notice thereof. However, holders of Class B non-voting common stock that are converted into Class A common stock will have all the voting rights of the other holders of Class A common stock. Class B non-voting common stock is not convertible in the hands of the initial holder. However, a transferee unaffiliated with the initial holder that receives Class B non-voting common stock subsequent to transfer permitted by CBF's certificate of incorporation may elect to convert each share of Class B non-voting common stock into one share of Class A common stock. Subsequent to the merger, upon conversion of any Class B non-voting common stock, your voting power will be diluted in proportion to the decrease in your ownership of the total outstanding Class A common stock.

***The market price of CBF's Class A common stock may be volatile, which could cause the value of an investment in CBF's Class A common stock to decline.***

The market price of CBF's Class A common stock may fluctuate substantially due to a variety of factors, many of which are beyond our control, including:

general market conditions;

domestic and international economic factors unrelated to CBF or Capital Bank's performance;

actual or anticipated fluctuations in CBF or Capital Bank's quarterly operating results;

changes in or failure to meet publicly disclosed expectations as to CBF or Capital Bank's future financial performance;

downgrades in securities analysts' estimates of CBF or Capital Bank's financial performance or lack of research and reports by industry analysts;

changes in market valuations or earnings of similar companies;

any future sales of CBF's common stock or other securities; and

additions or departures of key personnel.

The stock markets in general have experienced substantial volatility that has often been unrelated to the operating performance of particular companies. These types of broad market fluctuations may adversely affect the trading price of CBF's Class A common stock. In the past, stockholders have sometimes instituted securities class action litigation against companies following periods of volatility in the market price of their securities. Any similar litigation against the Company or CBF could result in substantial costs, divert management's attention and resources and harm our business or results of operations. For example, we are currently operating in, and have benefited from, a protracted period of historically low interest rates that will not be sustained indefinitely, and future fluctuations in interest rates could cause an increase in volatility of the market price of CBF's Class A common stock.

***CBF and the Company do not currently intend to pay dividends on shares of their common stock in the foreseeable future and the ability to pay dividends will be subject to restrictions under applicable banking laws and regulations.***

CBF and the Company do not currently intend to pay cash dividends on their common stock in the foreseeable future. The payment of cash dividends in the future will be dependent upon various factors, including earnings, if any, cash balances, capital requirements and general financial condition. The payment of any dividends will be within the discretion of the then-existing Board of Directors. It is the present intention of the Boards of Directors of the Company and CBF to retain all earnings, if any, for use in business operations in the foreseeable future and, accordingly, the Boards of Directors do not currently anticipate declaring any dividends. Because CBF and the Company do not expect to pay cash dividends on their common stock for some time, any gains on an investment in CBF's Class A common stock will be limited to the appreciation, if any, of the market value of the Class A common stock.

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Banks and bank holding companies are subject to certain regulatory restrictions on the payment of cash dividends. Federal bank regulatory agencies have the authority to prohibit bank holding companies from engaging in unsafe or unsound practices in conducting their business. The payment of dividends by CBF and the Company depending on their financial condition could be deemed an unsafe or unsound practice. The ability to pay dividends will directly depend on the ability of Capital Bank to pay dividends to us, which in turn will be restricted by the requirement that it maintains an adequate level of capital in accordance with requirements of its regulators and, in the future, can be expected to be further influenced by regulatory policies and capital guidelines. In addition, on August 24, 2010, Capital Bank entered into the OCC Operating Agreement that may restrict Capital Bank's ability to pay dividends to us, to make changes to its capital structure and to make certain other business decisions.

*Certain provisions of CBF's certificate of incorporation and the loss sharing agreements may have anti-takeover effects, which could limit the price investors might be willing to pay in the future for CBF's common stock and could entrench management. In addition, Delaware law may inhibit takeovers of CBF and could limit CBF's ability to engage in certain strategic transactions its Board of Directors believes would be in the best interests of stockholders.*

CBF's certificate of incorporation contains provisions that may discourage unsolicited takeover proposals that stockholders may consider to be in their best interests. These provisions include the ability of CBF's Board of Directors to designate the terms of and issue new series of preferred stock, which may make the removal of management more difficult and may discourage transactions that otherwise could involve payment of a premium over prevailing market prices for CBF's securities, including its Class A common stock.

The loss sharing agreements with the FDIC require that Capital Bank receive prior FDIC consent, which may be withheld by the FDIC in its sole discretion, prior to CBF, Capital Bank or the Company's stockholders engaging in certain transactions. If any such transaction is completed without prior FDIC consent, the FDIC would have the right to discontinue the relevant loss sharing arrangement. Among other things, prior FDIC consent is required for (1) a merger or consolidation of CBF or its bank subsidiary with or into another company if CBF's stockholders will own less than 66.66% of the combined company, (2) the sale of all or substantially all of the assets of any of CBF's bank subsidiary and (3) a sale of shares by a stockholder, or a group of related stockholders, that will effect a change in control of Capital Bank, as determined by the FDIC with reference to the standards set forth in the Change in Bank Control Act (generally, the acquisition of between 10% and 25% of any class of CBF's voting securities where the presumption of control is not rebutted, or the acquisition by any person, acting directly or indirectly or through or in concert with one or more persons, of 25% or more of any class of CBF's voting securities). If CBF or any stockholder desired to enter into any such transaction, the FDIC may not grant its consent in a timely manner, without conditions, or at all. If one of these transactions were to occur without prior FDIC consent and the FDIC withdrew its loss share protection, there could be a material adverse effect on Capital Bank's financial condition, results of operations and cash flows. In addition, statutes, regulations and policies that govern bank holding companies, including the BHCA, may restrict CBF's ability to enter into certain transactions.

CBF is also subject to anti-takeover provisions under Delaware law. CBF has not opted out of Section 203 of the Delaware General Corporation Law (which we refer to as the DGCL), which, subject to certain exceptions, prohibits a public Delaware corporation from engaging in a business combination (as defined in such section) with an interested stockholder (defined generally as any person who beneficially owns 15% or more of the outstanding voting stock of such corporation or any person affiliated with such person) for a period of three years following the time that such stockholder became an interested stockholder, unless (1) prior to such time the board of directors of such corporation approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder; (2) upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of such corporation at the time the transaction commenced (excluding for purposes of determining the voting stock outstanding (but not the outstanding voting stock owned by the interested stockholder) the voting stock owned by directors who are also officers or held in employee benefit plans in which the employees do not have a confidential right to tender or vote stock held by the plan); or (3) on or subsequent to such time the business combination is approved by the board of directors of such corporation and authorized at a meeting of stockholders by the affirmative vote of at least two-thirds of the outstanding voting stock of such corporation not owned by the interested stockholder.



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### **Risks Related to Our Common Stock**

*CBF is a controlling shareholder and may have interests that differ from the interests of our other shareholders.*

Upon completion of the CBF Investment, CBF owned approximately 90% of the Company's outstanding voting power. As a result, CBF will be able to control the election of our directors, determine our corporate and management policies and determine the outcome of any corporate transaction or other matter submitted to our shareholders for approval. Such transactions may include mergers and acquisitions (including the contemplated potential merger of the Company with and into CBF), sales of all or some of the Company's assets (including sales of such assets to CBF and/or CBF's other subsidiaries) or purchases of assets from CBF and/or CBF's other subsidiaries, and other significant corporate transactions.

Five of our seven directors, our Chief Executive Officer, our Chief Financial Officer, and our Chief Risk Officer are affiliated with CBF. CBF also has sufficient voting power to amend our organizational documents. The interests of CBF may differ from those of our other shareholders, and it may take actions that advance its interests to the detriment of our other shareholders. Additionally, CBF is in the business of making investments in or acquiring financial institutions and may, from time to time, acquire and hold interests in businesses that compete directly or indirectly with us. CBF may also pursue, for its own account, acquisition opportunities that may be complementary to our business, and as a result, those acquisition opportunities may not be available to us.

This concentration of ownership could also have the effect of delaying, deferring or preventing a change in our control or impeding a merger or consolidation, takeover or other business combination that could be favorable to the other holders of our common stock, and the trading prices of our common stock may be adversely affected by the absence or reduction of a takeover premium in the trading price.

*As a controlled company, we are exempt from certain Nasdaq corporate governance requirements.*

The Company's common stock is currently listed on the Nasdaq Global Select Market. The Nasdaq generally requires a majority of directors to be independent and requires independent director oversight over the nominating and executive compensation functions. However, under the rules applicable to the Nasdaq, if another company owns more than 50% of the voting power of a listed company, that company is considered a controlled company and exempt from rules relating to independence of the board of directors and the compensation and nominating committees. The Company is a controlled company because CBF beneficially owns more than 50% of the Company's outstanding voting stock. Accordingly, the Company is exempt from certain corporate governance requirements and its shareholders may not have all the protections that these rules are intended to provide.

*We may choose to voluntarily delist our common stock from Nasdaq or cease to be a reporting issuer under SEC rules.*

We may choose to, or our majority shareholder CBF may cause us to, voluntarily delist from the Nasdaq Global Select Market. If we were to delist from Nasdaq, we may or may not list ourselves on another exchange, and may or may not be required to continue to file periodic and current reports and other information as a reporting issuer under SEC rules. A delisting of our common stock could negatively impact shareholders by reducing the liquidity and market price of our common stock, reducing information available about the Company on an ongoing basis and potentially reducing the number of investors willing to hold or acquire our common stock. In addition, if we were to delist from Nasdaq, we would no longer be subject to any of the corporate governance rules applicable to Nasdaq listed companies. See also As a controlled company, we are exempt from certain Nasdaq corporate governance requirements.

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***Future issuance or sales of our common stock or other securities will dilute the ownership interests of our existing shareholders and could depress the market price of our common stock.***

In order to maintain our capital at desired levels or required regulatory levels, or to fund future growth, the Company Board may decide from time to time to issue additional shares of common stock, preferred stock or securities convertible into, exchangeable for or representing rights to acquire shares of our common stock. The sale of these shares may significantly dilute our shareholders' ownership interest and the per share book value of our common stock. New investors in the future may also have rights, preferences and privileges senior to our current shareholders which may adversely impact our current shareholders.

***Resales of our common stock or other securities in the public market may cause the market price of our common stock to fall.***

Sales of a substantial number of shares of our common stock in the public market by our shareholders (including CBF), or the perception that such sales are likely to occur, could cause the market price of our common stock to decline. Pursuant to the CBF Investment we have agreed to provide customary registration rights for the shares of common stock issued to CBF and CBF can exercise those rights in order to sell additional shares of our common stock at its discretion. We cannot predict the effect, if any, that future sales of our common stock in the market, or availability of shares of our common stock for sale in the market, will have on the market price of our common stock. We therefore can give no assurance that sales of substantial amounts of our common stock in the market, or the potential for large amounts of sales in the market, would not cause the price of our common stock to decline or impair our ability to raise capital through sales of our common stock.

***Market conditions and other factors may affect the value of our common stock.***

The trading price of the shares of our common stock will depend on many factors, which may change from time to time, including the factors substantially similar to those identified above under . The market price of CBF's Class A common stock may be volatile, which could cause the value of an investment in CBF's Class A common stock to decline.

***The trading volume in our common stock has been low and the sale of substantial amounts of our common stock in the public market could depress the price of our common stock.***

Our common stock is thinly traded. The average daily trading volume of our shares on The Nasdaq Global Select Market during 2011 was approximately 48,413 shares. Thinly traded stock can be more volatile than stock trading in an

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active public market. In recent years, the stock market has experienced a high level of price and volume volatility, and market prices for the stock of many companies have experienced wide price fluctuations that have not necessarily been related to their operating performance. Therefore, our shareholders may not be able to sell their shares at the volumes, prices, or times that they desire.

We cannot predict the effect, if any, that future sales of our common stock in the market, or availability of shares of our common stock for sale in the market, will have on the market price of our common stock. We therefore can give no assurance sales of substantial amounts of our common stock in the market, or the potential for large amounts of sales in the market, would not cause the price of our common stock to decline or impair our ability to raise capital through sales of our common stock.

***Holders of our junior subordinated debentures have rights that are senior to those of our common stockholders.***

We have supported our continued growth through the issuance of trust preferred securities from special purpose trusts and accompanying junior subordinated debentures. At December 31, 2011, we had outstanding trust preferred securities and accompanying junior subordinated debentures with face values totaling \$88.7 million. Payments of the principal and interest on the trust preferred securities of these special purpose trusts are conditionally guaranteed by us. Further, the accompanying junior subordinated debentures we issued to the special purpose trusts are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock. We have the right to defer distributions on our junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid on our common stock.

***An investment in our common stock is not an insured deposit.***

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this Risk Factors section and elsewhere in this report and is subject to the same market forces that affect the price of common stock in any company. As a result, our shareholders may lose some or all of their investment in our common stock.

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### **ITEM 1B. UNRESOLVED STAFF COMMENTS.**

We did not receive any written comments during 2011 from the Commission staff regarding our periodic and current reports under the Act that remain unresolved from any prior period.

### **ITEM 2. PROPERTIES.**

The information set forth on page 13 of Item 1, Business Facilities and Real Estate is incorporated herein by reference.

### **ITEM 3. LEGAL PROCEEDINGS.**

On November 18, 2010, a shareholder of the Company filed a putative class action lawsuit (styled *Bill Burgraff v. Green Bankshares, Inc., et al.*, U.S. District Court, Eastern District of Tennessee, Northeastern Division, Case No. 2:10-cv-00253) against the Company and certain of its current and former officers in the United States District Court for the Eastern District of Tennessee in Greeneville, Tennessee on behalf of all persons that acquired shares of Company common stock between January 19, 2010 and November 9, 2010. On January 18, 2011, a separate shareholder of the Company filed a putative class action lawsuit (styled *Brian Molnar v. Green Bankshares, Inc., et al.*, U.S. District Court, Eastern District of Tennessee, Northeastern Division, Case No. 2:11-cv-00014) against the Company and certain of its current and former officers in the same court on behalf of all persons that acquired shares of Company common stock between January 19, 2010 and October 20, 2010. These lawsuits were filed following, and relate to the drop in value of the Company's common stock price after, the Company announced its third quarter performance results on October 20, 2010. The plaintiffs allege that defendants made false and/or misleading statements or failed to disclose that the Company was purportedly overvaluing collateral of certain loans; failing to timely take impairment charges of these certain loans; failing to properly account for loan charge-offs; lacking adequate internal and financial controls; and providing false and misleading financial results. The plaintiffs have asserted federal securities laws claims against all defendants for alleged violations of Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act) and Rule 10b-5 promulgated thereunder. The plaintiffs have also asserted control person liability claims against the individual defendants named in the complaints pursuant to Section 20(a) of the Exchange Act. The two cases were consolidated on February 4, 2011. On February 11, 2011, the Court appointed movant Jeffrey Blomgren as lead plaintiff. On May 3, 2011, the plaintiff filed an amended and consolidated complaint alleging a class period of January 19, 2010 to November 9, 2010. On July 11, 2011, Defendants filed a motion to dismiss the consolidated amended complaint. We and the individual named by the defendants collectively intend to vigorously defend themselves against these allegations.

On May 12, 2011, a stockholder of the Company filed a putative class action lawsuit (styled *Betty Smith v. Green Bankshares, Inc., et al.*, Case No. 11-625-III, Davidson County, Tennessee, Chancery Court) against the Company, GreenBank, the Company Board and CBF on behalf of all persons holding common stock of the Company. This lawsuit was filed following our public announcement on May 5, 2011 of our entering into an investment agreement with CBF and relates to the investment in the Company by CBF. The complaint alleges that the individual defendants breached their fiduciary duties to the Company by accepting a sale price for the shares to be sold to us that was unfair to stockholders of the Company. The complaint also alleges that CBF, the Company and GreenBank aided and abetted these breaches of fiduciary duty. It seeks an injunction and/or rescission of the Green Bankshares investment and fees and expenses in an unspecified amount.

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On May 25 and June 16, 2011, two other stockholders of the Company filed similar putative class action lawsuits (styled *Mark McClinton v. Green Bankshares, Inc., et al.*, Case No. 11-CV-284kt, Greene County Circuit Court, Greeneville, Tennessee and *Thomas Cook v. Green Bankshares, Inc. et al.*, Case No. 2:11-cv-00176, Greenville Division, E.D. Tenn., respectively) against the Company, the Company Board and CBF on behalf of all persons holding common stock of the Company. The complaints similarly allege that the individual defendants breached their fiduciary duties to the Company by agreeing to sell shares to us at a price unfair to stockholders of the Company. The complaints also allege that CBF and the Company aided and abetted these breaches of fiduciary duty. In addition, the Cook complaint further alleges that the proxy statement filed with the SEC by the Company in connection with the transaction was issued with material omissions and misleading statements. Both claims seek an injunction and/or rescission of the CBF Investment and fees and expenses in an unspecified amount.

On July 6, 2011, another shareholder of the Company filed a lawsuit (styled *Barbara N. Ballard v. Stephen M. Rownd, et al.*, Civil Action No. 2:11-cv-00201, E.D. Tenn.) against Green Bankshares, its Board of Directors and CBF asserting an individual claim that alleges that the individual defendants violated the securities laws by issuing a preliminary proxy statement that contains alleged material misstatements and omissions. The complaint also alleges a class action claim on behalf of all persons holding the Green Bankshares common stock against the individual defendants for breach of fiduciary duty based on these same alleged material misstatements and omissions. The complaint also alleges that Green Bankshares and CBF aided and abetted the breaches of fiduciary duty. It seeks an injunction and/or rescission of the CBF Investment and fees and expenses in an unspecified amount.

On July 26, 2011, the parties to the above-referenced class action lawsuits commenced in 2011 (other than the Molnar case) reached an agreement in principle to resolve these lawsuits on the basis of the inclusion of certain additional disclosures regarding the CBF Investment proxy statement filed with the SEC on the same date. The proposed settlement is subject to, among other things, court approval. On February 3, 2012, the court in the *Smith* action entered a final order resolving all claims and, on February 15, 2012, the *Cook* action was dismissed by the court with prejudice.

From time to time we are a party to various litigation matters incidental to the conduct of our business. We are not presently party to any such legal proceeding the resolution of which we believe would have a material adverse effect on our business, operating results, financial condition or cash flow.

## **ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

On April 5, 2012, Green Bankshares, Inc. had 133,160,384 shares of common stock outstanding, of which 119,900,000 are owned by CBF. The Company's shares are traded on The Nasdaq Global Select Market, under the symbol GRNB. As of March 23, 2012, Green Bankshares, Inc. has 2527 registered shareholders and 84 brokers for 2,611 holders of its common stock.

The following table shows the high and low sales price and closing price for the Company's common stock as reported by The Nasdaq Global Select Market for 2011 and 2010.

	High/Low Sales Price During Quarter	Closing Price	Dividends Paid Per Share
<b>2011:</b>			
First quarter	\$ 3.89 / 2.51	\$ 2.79	\$
Second quarter	3.30 / 1.99	2.62	
Third quarter	2.90 / 1.20	1.26	
Fourth quarter	1.68 / 1.05	1.21	\$
<b>2010:</b>			
First quarter	\$ 9.48 / 3.52	\$ 8.16	\$
Second quarter	15.04 / 7.96	12.77	
Third quarter	13.11 / 6.58	6.79	
Fourth quarter	7.73 / 2.39	3.20	