

CAMDEN NATIONAL CORP  
Form 10-K  
March 02, 2012

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

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

**For the Fiscal Year Ended December 31, 2011**

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

**Commission File No. 0-28190**

**CAMDEN NATIONAL CORPORATION**

(Exact Name of Registrant As Specified in Its Charter)

Maine  
(State or Other Jurisdiction of  
Incorporation or Organization)

01-0413282  
(I.R.S. Employer  
Identification No.)

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2 Elm Street, Camden, ME

04843

(Address of Principal Executive Offices)

(Zip Code)

Registrant's Telephone Number, Including Area Code: **(207) 236-8821**

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

Title of Each Class

Name of Exchange on Which Registered

Common Stock, without par value

The NASDAQ Stock Market LLC

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 periods 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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the Registrant's most recently completed second fiscal quarter: \$228,741,739. Shares of the Registrant's common stock held by each executive officer, director and person who beneficially owns 5%

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or more of the Registrant's outstanding common stock have been excluded, in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of each of the registrant's classes of common stock, as of February 28, 2012 is:  
Common Stock: 7,666,962.

Listed hereunder are documents incorporated by reference and the relevant Part of the Form 10-K into which the document is incorporated by reference:

Certain information required in response to Items 10, 11, 12, 13 and 14 of Part III of this Form 10-K are  
(1) incorporated by reference from Camden National Corporation's Definitive Proxy Statement for the 2012 Annual Meeting of Shareholders pursuant to Regulation 14A of the General Rules and Regulations of the Commission.

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2011 FORM 10-K ANNUAL REPORT**

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## FORWARD-LOOKING STATEMENTS

The discussions set forth below and in the documents we incorporate by reference herein contain certain statements that may be considered forward-looking statements under the Private Securities Litigation Reform

Act of 1995, including certain plans, exceptions, goals, projections, and statements, which are subject to numerous risks, assumptions, and uncertainties. Forward-looking statements can be identified by the use of the words believe, expect, anticipate, intend, estimate, assume, plan, target, or goal or future or such as will, may, might, should, could and other expressions which predict or indicate future events or trends and which do not relate to historical matters. Forward-looking statements should not be relied on, because they involve known and unknown risks, uncertainties and other factors, some of which are beyond the control of the Company. These risks, uncertainties and other factors may cause the actual results, performance or achievements of the Company to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements.

Although the Company believes that the expectations reflected in the Company's forward-looking statements are reasonable, these statements involve risks and uncertainties that are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, among others, could cause the Company's financial performance to differ materially from the Company's goals, plans, objectives, intentions, expectations and other forward-looking statements:

*continued weakness in the United States economy in general and the regional and local economies within the New England region and Maine, which could result in a deterioration of credit quality, a change in the allowance for loan losses, or a reduced demand for the Company's credit or fee-based products and services;  
adverse changes in the local real estate market could result in a deterioration of credit quality and an increase in the allowance for loan loss, as most of the Company's loans are concentrated in Maine, and a substantial portion of these loans have real estate as collateral;*

*changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System;*

*inflation, interest rate, market and monetary fluctuations;  
adverse changes in asset;*

*competitive pressures, including continued industry consolidation, the increased financial services provided by non-banks and banking reform;*

*continued volatility in the securities markets that could adversely affect the value or credit quality of the Company's assets, impairment of goodwill, the availability and terms of funding necessary to meet the Company's liquidity needs, and the Company's ability to originate loans and could lead to impairment in the value of securities in the Company's investment portfolios;*

*changes in information technology that require increased capital spending;*

*changes in consumer spending and savings habits;*

*new laws and regulations regarding the financial services industry including but not limited to, the Dodd-Frank Wall Street Reform & Consumer Protection Act;*

*changes in laws and regulations including laws and regulations concerning taxes, banking, securities and insurance; and*

*changes in accounting policies, practices and standards, as may be adopted by the regulatory agencies as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, and other accounting standard setters.*

You should carefully review all of these factors, and be aware that there may be other factors that could cause differences, including the risk factors listed in Part II, Item 1A, Risk Factors, beginning



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on page 12. Readers should carefully review the risk factors described therein and should not place undue reliance on our forward-looking statements.

These forward-looking statements were based on information, plans and estimates at the date of this report, and we do not promise to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

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## PART I

### Item 1. Business

*Overview.* Camden National Corporation (hereafter referred to as we, our, us, or the Company) is a publicly-held bank holding company, with \$2.3 billion in assets at December 31, 2011, incorporated under the laws of the State of Maine and headquartered in Camden, Maine. The Company, as a diversified financial services provider, pursues the objective of achieving long-term sustainable growth by balancing growth opportunities against profit, while mitigating risks inherent in the financial services industry. The primary business of the Company and its subsidiaries is to attract deposits from, and to extend loans to, consumer, institutional, municipal, non-profit and commercial customers. The Company makes its commercial and consumer banking products and services available directly and indirectly through its subsidiary, Camden National Bank (the Bank), and its brokerage and insurance services through Camden Financial Consultants (Camden Financial), a division of the Bank. The Company also provides wealth management, trust and employee benefit products and services through its subsidiary, Acadia Trust, N.A. (Acadia Trust), a federally regulated, non-depository trust company headquartered in Portland, Maine. In addition to serving as a holding company, the Company provides managerial, operational, human resource, marketing, financial management, risk management and technology services to its subsidiaries. The Consolidated Financial Statements of the Company accompanying this Form 10-K include the accounts of the Company, the Bank and its divisions, and Acadia Trust. All inter-company accounts and transactions have been eliminated in consolidation.

### Descriptions of the Company and the Company's Subsidiaries

*The Company.* Following is a timeline of recent major events of the Company:

On January 3, 2008, the Company acquired Union Bankshares Company, Maine, including its principal wholly-owned subsidiary, Union Trust Company. Union Trust Company became a division of the Bank.

On February 22, 2011, the Union Trust division was merged into the Bank.

As of December 31, 2011, the Company's securities consisted of one class of common stock, no par value, of which there were 7,664,975 shares outstanding held of record by approximately 1,700 shareholders. Such number of record holders does not reflect the number of persons or entities holding stock in nominee name through banks, brokerage firms and other nominees, which is estimated to be 3,500 shareholders.

The Company is a bank holding company (BHC) registered under the Bank Holding Company Act of 1956, as amended (the BHCA), and is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System (the FRB).

*Camden National Bank.* The Bank, a direct, wholly-owned subsidiary of the Company, is a national banking association chartered under the laws of the United States and having its principal office in Camden, Maine. Originally founded in 1875, the Bank became a direct, wholly-owned subsidiary of the Company as a result of the corporate reorganization in 1985. The Bank offers its products and services in the Maine counties of Androscoggin, Cumberland, Franklin, Hancock, Knox, Lincoln, Penobscot, Piscataquis, Somerset, Waldo, Washington, and York, and focuses primarily on attracting deposits from the general public through its branches, and then using such deposits to originate residential mortgage loans, commercial business loans, commercial real estate loans and a variety of consumer loans. Customers may also access the Bank's products and services using other channels, including the Bank's website located at [www.camdennational.com](http://www.camdennational.com). The Bank is a member bank of the Federal Reserve System and is subject to supervision, regulation and examination by the Office of the Comptroller of the Currency (the OCC). The

Federal Deposit Insurance Corporation (the FDIC ) insures the deposits of the Bank up to the maximum amount permitted by law.

*Camden Financial Consultants, located at Camden National Bank.* Camden Financial is a full-service brokerage and insurance division of the Bank, which is in the business of helping clients meet all of their financial needs by using a total wealth management approach. Its financial offerings include college, retirement, and estate planning, mutual funds, Strategic Asset Management accounts, and variable and fixed annuities.

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*Acadia Trust, N.A.* Acadia Trust, a direct, wholly-owned subsidiary of the Company, is a national banking association chartered under the laws of the United States with a limited purpose trust charter, and has its principal office in Portland, Maine, and a website located at [www.acadiatrust.com](http://www.acadiatrust.com). Acadia Trust provides a broad range of trust, trust-related, investment and wealth management services, in addition to retirement and pension plan management services, to both individual and institutional clients. The financial services provided by Acadia Trust complement the services provided by the Bank by offering customers investment management services. Acadia Trust is a member bank of the Federal Reserve System and is subject to supervision, regulation and examination by the OCC as well as to supervision, examination and reporting requirements under the BHCA and the regulations of the FRB.

*Competition.* Through the Bank and its division, Camden Financial, the Company competes throughout the State of Maine, and considers its primary market areas to be in Knox, Hancock, Waldo, Penobscot, and Franklin counties, with a growing presence in Cumberland, Lincoln, Androscoggin and York counties. The combined population of the two primary counties of Knox and Waldo is approximately 81,000 people and their economies are based primarily on tourism and fishing and supported by a substantial population of retirees. The Bank's downeast, central and western Maine markets are characterized as rural areas, with the exception of Bangor and Lewiston, which have populations of approximately 33,000 and 37,000, respectively. Major competitors in the Company's market areas include local branches of large regional bank affiliates and brokerage houses, as well as local independent banks, financial advisors, thrift institutions and credit unions. Other competitors for deposits and loans within the Bank's primary market areas include insurance companies, money market funds, consumer finance companies and financing affiliates of consumer durable goods manufacturers.

The Company and its banking subsidiary generally have effectively competed with other financial institutions by emphasizing customer service, which it has branded the Camden National Experience, including local decision-making, establishing long-term customer relationships, building customer loyalty and providing products and services designed to meet the needs of customers. No assurance can be given, however, that in the future, the Company and its banking subsidiary will continue to be able to effectively compete with other financial institutions.

The Company, through its non-bank subsidiary, Acadia Trust, competes for trust, trust-related, investment management, retirement and pension plan management services with local banks and non-banks, which may now, or in the future, offer a similar range of services, as well as with a number of brokerage firms and investment advisors with offices in the Company's market area. In addition, most of these services are widely available to the Company's customers by telephone and over the internet through firms located outside the Company's market area.

*The Company's Philosophy.* The Company is committed to the philosophy of serving the financial needs of customers in local communities, as described in its core purpose: *Through each interaction, we will enrich the lives of people, help businesses succeed and vitalize communities.* The Company, through the Bank, has branches that are located in communities within the Company's geographic market areas. The Company believes that its comprehensive retail, small business and commercial loan products enable the Bank to effectively compete.

*The Company's Growth.* The Company has achieved a five-year compounded annual asset growth rate of 5.4%, resulting in \$2.3 billion in total assets as of the end of 2011. The primary factor contributing to the growth was the acquisition of Union Trust. The financial services industry continues to experience consolidations through mergers that could create opportunities for the Company to promote its value proposition to customers. The Company evaluates the possibility of expansion into new markets through both de novo expansion and acquisitions. In addition, the Company is focused on maximizing the potential for growth in existing markets, especially in markets where the Company has less of a presence.

*The Company's Employees.* The Company employs approximately 425 people on a full- or part-time basis, which calculates into 410 people on a full-time equivalent basis. The Company's management measures the corporate culture

every 18 months and is pleased with the most recent rating, which came in as a positive culture, signifying that employees understand and support the overall Company objectives and

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strategies. In 2009, the Company was named one of the top two Best Places to Work in Maine in the large-size category (200 or more employees) by ModernThink, a workplace excellence firm. There are no known disputes between management and employees.

*The Company's Employee Incentives.* All Company employees are eligible for participation in the Company's performance-based incentive compensation program and Retirement Savings 401(k) Plan, while certain officers of the Company may also participate in various components of the Company's 2003 Stock Option Plan, Supplemental Executive Retirement Plan, Postretirement Medical Plan, Defined Contribution Retirement Plan, Executive Incentive Compensation Program, Deferred Compensation Plan and Long-term Incentive Plan.

## **Supervision and Regulation**

The business in which the Company and its subsidiaries are engaged is subject to extensive supervision, regulation and examination by various federal regulatory agencies (the Agencies), including the FRB and the OCC. The Bank is also subject to regulation under the laws of the State of Maine and the jurisdiction of the Maine Bureau of Financial Institutions. State and federal banking laws generally have as their principal objective either the maintenance of the safety and soundness of financial institutions and the federal deposit insurance system or the protection of consumers or classes of consumers, and depositors in particular, rather than the specific protection of shareholders. Set forth below is a brief description of certain laws and regulations that relate to the regulation of the Company and its banking subsidiaries.

*Regulatory Reform.* The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) comprehensively reformed the regulation of financial institutions, products and services. Among other things, the Dodd-Frank Act:

bars banking organizations, such as the Company, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited circumstances, as discussed in Supervision and Regulation Bank Holding Company Activities and Other Limitations and Supervision and Regulation Activities and Investments of National Banking Associations below;

codifies the source of strength doctrine, as discussed in more detail in Supervision and Regulation Bank Holding Company Support of Subsidiary Banks below;

grants the FRB increased supervisory authority allowing it to directly examine the subsidiaries of the Company, including the Bank;

provides for new capital standards applicable to the Company and the Bank, as discussed in more detail in Supervision and Regulation Capital Requirements below;

modifies deposit insurance coverage, as discussed in Supervision and Regulation Deposit Insurance below;

established the Bureau of Consumer Financial Protection (the CFPB), as discussed in Consumer Protection Regulation Consumer Protection Laws General below;

established a new standard for preemption of state consumer financial laws, which will affect national banking associations such as the Bank, as discussed in Consumer Protection Regulation Preemption of State Consumer Protection Laws below;

established new minimum mortgage underwriting standards for residential mortgages, as discussed in Consumer Protection Regulation Mortgage Reform below;

established new corporate governance and proxy disclosure requirements, as discussed in Other Regulatory Requirements Corporate Governance and Executive Compensation below;



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authorizes the FRB to regulate interchange fees for debit card transactions. The FRB has issued a rule governing the interchange fees charged on debit cards which caps the fees a bank may charge on a debit card transactions and shifts such interchange fees from a percentage of the transaction amount to a per transaction fee. Although the rule does not directly apply to institutions with less than \$10 billion in assets, market forces may result in debit card issuers of all sizes adopting fees that comply with this rule;

permits the payment of interest on business demand deposit accounts;  
established and empowered the Financial Stability Oversight Council to designate certain activities as posing a risk to the U.S. financial system and recommend new or heightened standards and safeguards for financial institutions engaging in such activities; and  
established the Office of Financial Research, which has the power to require reports from financial services companies such as the Company.

*Bank Holding Company Activities and Other Limitations.* As a BHC, the Company is subject to regulation under the BHCA. In addition, the Company is subject to examination and supervision by the FRB, and is required to file reports with, and provide additional information requested by, the FRB.

Under the BHCA, the Company may not generally engage in activities or acquire more than 5% of any class of voting securities of any company which is not a bank or BHC, and may not engage directly or indirectly in activities other than those of banking, managing or controlling banks or furnishing services to its subsidiary banks, except that it may engage in and may own shares of companies engaged in certain activities the FRB determined to be so closely related to banking or managing and controlling banks as to be a proper incident thereto. However, a BHC that has elected to be treated as a financial holding company may engage in activities that are financial in nature or incidental or complementary to such financial activities, as determined by the FRB alone, or together with the Secretary of the Department of the Treasury. The Company has not elected financial holding company status. Under certain circumstances, the Company may be required to give notice to or seek approval of the FRB before engaging in activities other than banking. Additionally, the Dodd-Frank Act bars banking organizations, such as the Company, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited circumstances.

*Acquisitions and Branching.* The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ( Riegle-Neal ) and the Dodd-Frank Act permit well capitalized and well managed BHCs and banks, as determined by the FRB and the OCC, respectively, to acquire banks in any state subject to certain concentration limits and other conditions. Riegle-Neal also generally authorizes the interstate merger of banks. In addition, among other things, Riegle-Neal and the Dodd-Frank Act permit banks to establish new branches on an interstate basis to the same extent a bank chartered by the host state may establish branches. However, as a BHC, we are required to obtain prior FRB approval before acquiring more than 5% of a class of voting securities, or substantially all of the assets, of a BHC, bank or savings association.

The Change in Bank Control Act prohibits a person or group of persons from acquiring control of a BHC, such as the Company, unless the FRB has been notified and has not objected to the transaction. Under a rebuttable presumption established by the FRB, the acquisition of 10% or more of a class of voting securities of a BHC with a class of securities registered under Section 12 of the Exchange Act would, under the circumstances set forth in the presumption, constitute acquisition of control of the BHC. In addition, a company is required to obtain the approval of the FRB under the BHCA before acquiring 25% (5% in the case of an acquirer that is a BHC) or more of any class of outstanding voting securities of a BHC, or otherwise obtaining control or a controlling influence over that BHC. In September 2008, the FRB released guidance on minority investment in banks which relaxed the presumption of control for investments of greater than 10% of a class of outstanding voting securities of a BHC in certain instances discussed in the guidance.

*Activities and Investments of National Banking Associations.* National banking associations must comply with the National Bank Act and the regulations promulgated thereunder by the OCC, which limit the activities of national banking associations to those that are deemed to be part of, or incidental to, the business of banking. Activities that are part of, or incidental to, the business of banking include taking



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deposits, borrowing and lending money and discounting or negotiating paper. Subsidiaries of national banking associations generally may only engage in activities permissible for the parent national bank. As noted above, the Dodd-Frank Act bars the Bank from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited circumstances.

*Bank Holding Company Support of Subsidiary Banks.* Under the Dodd-Frank Act, the Company is required to serve as a source of financial strength for the Bank in the event of the financial distress of the Bank. This provision codifies the longstanding policy of the FRB. This support may be required at times when the BHC may not have the resources to provide it. Similarly, under the cross-guarantee provisions of the Federal Deposit Insurance Act, as amended (the FDIA ), the FDIC can hold any FDIC-insured depository institution liable for any loss suffered or anticipated by the FDIC in connection with (1) the default of a commonly controlled FDIC-insured depository institution; or (2) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default.

*Transactions with Affiliates.* Under Sections 23A and 23B of the Federal Reserve Act and Regulation W promulgated thereunder, there are various legal restrictions on the extent to which a BHC and its nonbank subsidiaries may borrow, obtain credit from or otherwise engage in covered transactions with its FDIC-insured depository institution subsidiaries. Such borrowings and other covered transactions by an insured depository institution subsidiary (and its subsidiaries) with its nondepository institution affiliates are limited to the following amounts: in the case of one such affiliate, the aggregate amount of covered transactions of the insured depository institution and its subsidiaries cannot exceed 10% of the capital stock and surplus of the insured depository institution; and in the case of all affiliates, the aggregate amount of covered transactions of the insured depository institution and its subsidiaries cannot exceed 20% of the capital stock and surplus of the insured depository institution. The Dodd-Frank Act amended the definition of affiliate to include an investment fund for which the depository institution or one of its affiliates is an investment adviser. Covered transactions are defined by statute for these purposes to include a loan or extension of credit to an affiliate, a purchase of or investment in securities issued by an affiliate, a purchase of assets from an affiliate unless exempted by the FRB, the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any person or company, the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate, securities borrowing or lending transactions with an affiliate that creates a credit exposure to such affiliate, or a derivatives transaction with an affiliate that creates a credit exposure to such affiliate. Covered transactions are also subject to certain collateral security requirements. Further, a BHC and its subsidiaries are prohibited from engaging in certain tying arrangements in connection with any extension of credit, lease or sale of property of any kind, or furnishing of any service.

*Declaration of Dividends.* According to its Policy Statement on Cash Dividends Not Fully Covered by Earnings (the FRB Dividend Policy ), the FRB considers adequate capital to be critical to the health of individual banking organizations and to the safety and stability of the banking system. Of course, one of the major components of the capital adequacy of a bank or a BHC is the strength of its earnings, and the extent to which its earnings are retained and added to capital or paid to shareholders in the form of cash dividends. Accordingly, the FRB Dividend Policy suggests that banks and BHCs generally should not maintain their existing rate of cash dividends on common stock unless the organization's net income available to common shareholders over the past year has been sufficient to fully fund the dividends, and the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. The FRB Dividend Policy reiterates the FRB's belief that a BHC should not maintain a level of cash dividends to its shareholders that places undue pressure on the capital of bank subsidiaries, or that can be funded only through additional borrowings or other arrangements that may undermine the BHC's ability to serve as a source of strength. The FRB has the authority to prohibit a BHC, such as the Company, from paying dividends if it deems such payment to be an unsafe or unsound practice.

Under Maine law, a corporation's board of directors may declare, and the corporation may pay, dividends on its outstanding shares, in cash or other property, generally only out of the corporation's unreserved and unrestricted earned surplus, or out of the unreserved and unrestricted net earnings of the current fiscal year and the next preceding fiscal year taken as a single period, except under certain circumstances, including when the corporation is insolvent, or when the payment of the dividend would render the corporation insolvent or when the declaration would be contrary to the corporation's charter.

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The revenue of the Company is derived substantially from interest and dividends paid to it by the Bank. Dividend payments by national banks, such as the Bank, also are subject to certain restrictions. For instance, national banks generally may not declare a dividend in excess of the bank's undivided profits and, absent OCC approval, if the total amount of dividends declared by the national bank in any calendar year exceeds the total of the national bank's retained net income of that year to date combined with its retained net income for the preceding two years. National banks also are prohibited from declaring or paying any dividend if, after making the dividend, the national bank would be considered undercapitalized (as defined by reference to other OCC regulations). The OCC has the authority to use its enforcement powers to prohibit a national bank, such as the Bank, from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis.

*Capital Requirements.* The FRB and the OCC have issued substantially similar risk-based and leverage capital guidelines applicable to United States banking organizations. In addition, the Agencies may from time to time require that a banking organization maintain capital above the minimum levels, whether because of its financial condition or actual or anticipated growth.

The FRB's risk-based guidelines define a three-tier capital framework. Tier 1 capital for bank holding companies generally consists of the sum of common stockholders' equity, perpetual preferred stock and trust preferred securities (both subject to certain limitations and, in the case of the latter, to specific limitations on the kind and amount of such securities which may be included as Tier 1 capital and certain additional restrictions described below), and minority interests in the equity accounts of consolidated subsidiaries, less goodwill and other non-qualifying intangible assets. Pursuant to the Dodd-Frank Act, trust preferred securities issued after May 19, 2010, will not count as Tier 1 capital; however, the Company's currently outstanding trust preferred securities have been grandfathered for Tier 1 eligibility.

Tier 2 capital generally consists of hybrid capital instruments, perpetual debt and mandatory convertible debt securities; perpetual preferred stock and trust preferred securities, to the extent it is not eligible to be included as Tier 1 capital; term subordinated debt and intermediate-term preferred stock; and, subject to limitations, general allowances for loan losses. The sum of Tier 1 and Tier 2 capital less certain required deductions, such as investments in unconsolidated banking or finance subsidiaries, represents qualifying total capital. Risk-based capital ratios are calculated by dividing Tier 1 and total capital, respectively, by risk-weighted assets. Assets and off-balance sheet credit equivalents are assigned to one of four categories of risk-weights, based primarily on relative credit risk. The minimum Tier 1 risk-based capital ratio is 4% and the minimum total risk-based capital ratio is 8%. The Dodd-Frank Act requires the FRB to establish minimum risk-based capital requirements that may not be lower than those in effect on July 21, 2010. As of December 31, 2011, the Company's Tier 1 risk-based capital ratio was 14.69% and its total risk-based capital ratio was 15.95%.

In addition to the risk-based capital requirements, the FRB requires top rated bank holding companies to maintain a minimum leverage capital ratio of Tier 1 capital (defined by reference to the risk-based capital guidelines) to its average total consolidated assets of at least 3.0%. For most other bank holding companies (including the Company), the minimum leverage capital ratio is 4.0%. Bank holding companies with supervisory, financial, operational or managerial weaknesses, as well as bank holding companies that are anticipating or experiencing significant growth, are expected to maintain capital ratios well above the minimum levels. The Company's leverage capital ratio was 9.59% as of December 31, 2011.

Pursuant to the Dodd-Frank Act, as with the risk-based capital requirements discussed above, the leverage capital requirements generally applicable to insured depository institutions will serve as a floor for any leverage capital requirements the FRB may establish for bank holding companies, such as the Company. The Dodd-Frank Act also specifies that the FRB may not establish leverage capital requirements for bank holding companies that are quantitatively lower than the leverage capital requirements in effect for insured depository institutions as of July 21,

2010.

The OCC has promulgated regulations and adopted a statement of policy regarding the capital adequacy of national banks. These requirements are substantially similar to those adopted by the FRB regarding bank holding companies, as described above. Moreover, the OCC has promulgated corresponding regulations to implement the system of prompt corrective action established by Section 38 of the Federal Deposit Insurance

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Act ( FDIA ). Under the regulations, a bank is well capitalized if it has: (1) a total risk-based capital ratio of 10.0% or greater; (2) a Tier 1 risk-based capital ratio of 6.0% or greater; (3) a leverage ratio of 5.0% or greater; and (4) is not subject to any written agreement, order, capital directive or prompt corrective action directive to meet and maintain a specific capital level for any capital measure. A bank is adequately capitalized if it has: (1) a total risk-based capital ratio of 8.0% or greater; (2) a Tier 1 risk-based capital ratio of 4.0% or greater; and (3) a leverage ratio of 4.0% or greater (3.0% under certain circumstances) and does not meet the definition of a well capitalized bank.

The OCC also must take into consideration: (1) concentrations of credit risk; (2) interest rate risk; and (3) risks from non-traditional activities, as well as an institution's ability to manage those risks, when determining the adequacy of an institution's capital. This evaluation will be made as a part of the institution's regular safety and soundness examination. At December 31, 2011, the Bank was deemed to be a well capitalized institution for the above purposes. Information concerning the Company and its subsidiaries with respect to capital requirements is incorporated by reference from Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, in the section entitled Capital Resources, and Item 8. Financial Statements and Supplementary Data, in the section entitled Note 18, Regulatory Capital Requirements.

Generally, a bank, upon receiving notice that it is not adequately capitalized (i.e., that it is undercapitalized), becomes subject to the prompt corrective action provisions of Section 38 of FDIA that, for example, (i) restrict payment of capital distributions and management fees, (ii) require that the OCC monitor the condition of the institution and its efforts to restore its capital, (iii) require submission of a capital restoration plan, (iv) restrict the growth of the institution's assets and (v) require prior regulatory approval of certain expansion proposals. A bank that is required to submit a capital restoration plan must concurrently submit a performance guarantee by each company that controls the bank. A bank that is critically undercapitalized (i.e., has a ratio of tangible equity to total assets that is equal to or less than 2.0%) will be subject to further restrictions, and generally will be placed in conservatorship or receivership within 90 days.

The Company has not elected, and does not expect to elect, to calculate its risk-based capital requirements under either the advanced or standard approach of the Basel II capital accords. The Basel Committee on Banking Supervision has also released new capital requirements, known as Basel III, setting forth higher capital requirements, enhanced risk coverage, a global leverage ratio, provisions for counter-cyclical capital, and liquidity standards. The FRB has not yet adopted Basel III, and when it is implemented in the United States, it may be with some modifications or adjustments. Additionally, the timetable for the adoption and implementation of Basel III is expected to last for several years. Accordingly, the Company is not yet in a position to determine the effect of Basel III on its capital requirements.

The Agencies may raise capital requirements applicable to banking organizations beyond current levels. The Company is unable to predict whether higher capital requirements will be imposed and, if so, at what levels and on what schedules. Therefore, the Company cannot predict what effect such higher requirements may have on it.

*Deposit Insurance.* The Bank pays deposit insurance premiums to the FDIC based on an assessment rate established by the FDIC. For most banks and savings associations, including the Bank, FDIC rates depend upon a combination of CAMELS component ratings and financial ratios. CAMELS ratings reflect the applicable bank regulatory agency's evaluation of the financial institution's capital, asset quality, management, earnings, liquidity and sensitivity to risk. For large banks and savings associations that have long-term debt issuer ratings, assessment rates depend upon such ratings, and CAMELS component ratings. Pursuant to the Dodd-Frank Act, deposit premiums are now based on assets rather than insurable deposits. To determine its actual deposit insurance premiums, the Bank will compute the base amount on its average consolidated assets less its average tangible equity (defined as the amount of Tier 1 capital) and its applicable assessment rate. The new assessment formula was effective on April 1, 2011, and was used to calculate

the June 30, 2011 assessment. Future expenses will be based on asset levels, Tier 1 capital levels, assessment rates, CAMELS ratings, and whether there are any future special assessments by the FDIC.

